Nos. 87-453 and 87-464

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

AMERADA HESS CORPORATION, *et al.*,
Appellants,
v.

DIRECTOR, DIVISION OF TAXATION,
Appellee.

TEXACO INC. and TENNECO OIL COMPANY,
Appellants,
v.

DIRECTOR, DIVISION OF TAXATION,
NEW JERSEY DEPARTMENT OF THE TREASURY,
Appellee.

On Appeals from the Supreme Court of New Jersey

BRIEF FOR APPELLANTS

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QUESTION PRESENTED

Whether the Due Process, Commerce, and Equal Protection Clauses of the United States Constitution permit a state, in defining the taxable net income of a multistate corporation, to include income derived from an exclusively out-of-state business activity but to deny an offset for associated costs incurred solely on account of that activity.

LIST OF PARTIES AND RULE 28.1 STATEMENT

This brief is filed on behalf of the following appellants, each of whom was a party in the Supreme Court of New Jersey:

Amerada Hess Corporation
Atlantic Richfield Company
Chevron U.S.A. Inc.
Cities Service Company
Conoco Inc.
Exxon Corporation
Gulf Oil Corporation
Mobil Oil Corporation
Phillips Petroleum Company
Shell Oil Company
Tenneco Oil Company
Texaco Inc.
Union Oil Company of California

The remaining parties in the Supreme Court of New Jersey were:

Diamond Shamrock Corporation
Director, Division of Taxation, New Jersey
  Department of the Treasury

The lists of appellants' affiliates required by Rule 28.1 are set forth in Appendix I (pp. 105a-155a) to the Jurisdictional Statement in No. 87-453 and Appendix G (pp. 70a-72a) to the Jurisdictional Statement in No. 87-464. Amendments to those lists to make them currently accurate are set forth in Appendix D to this brief, *infra*, at 11a-20a.

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On Appeals from the Supreme Court of New Jersey

BRIEF FOR APPELLANTS

OPINIONS BELOW

The opinion of the Supreme Court of New Jersey (J.S. App. 1a-35a)[1] is reported at 107 N.J. 307, 526 A.2d 1029. The opinion of the Appellate Division of the Superior Court of New Jersey (J.S. App. 36a-42a) is reported at 208 N.J. Super. 201, 505 A.2d 186. The opin-

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[1] "J.S. App." refers to the Appendix to the Jurisdictional Statement in No. 87-453. "Texaco J.S. App." refers to the Appendix to the Jurisdictional Statement in No. 87-464. "J.A." refers to the Joint Appendix in these consolidated appeals.

ion of the Tax Court of New Jersey (J.S. App. 43a-49a) is reported at 7 N.J. Tax 51, and its opinion denying reconsideration (J.S. App. 50a-61a) is reported at 7 N.J. Tax 275.

JURISDICTION

The judgment of the Supreme Court of New Jersey was entered on June 22, 1987. J.S. App. 1a. Notices of appeal to this Court were timely filed in the Supreme Court of New Jersey on August 20 and 21, 1987. J.S. App. 62a-83a; Texaco J.S. App. 56a-61a. These appeals were docketed on September 18, 1987, and the Court noted probable jurisdiction on May 16, 1988. J.A. 43-44. The jurisdiction of this Court rests on 28 U.S.C. § 1257 (2).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The relevant provisions of the United States Constitution, the New Jersey Corporation Business Tax Act, and the Crude Oil Windfall Profit Tax Act of 1980 are set forth at J.S. App. 92a-104a.

STATEMENT

Appellants are 13 vertically integrated oil and gas companies. They engage in all aspects of the petroleum business, including exploration, production, refining, transportation, distribution, and marketing. J.S. App. 2a; J.A. 11. They do business and own property throughout the United States. J.A. 11-12.

Appellants produce no crude oil in New Jersey. J.S. App. 2a. The state has no oil production and no proven oil reserves.[2] Several of the appellants do conduct refining operations in New Jersey, and all of them market petroleum products in that state. J.S. App. 2a; J.A. 12-15. They compete at both the wholesale and retail levels not only with each other but also with non-producer independent refiners and marketers.

As a producer of crude oil, each appellant is subject to the federal Crude Oil Windfall Profit Tax ("WPT"), an excise tax imposed on the "removal" of each barrel of crude oil from the producing premises. In addition, as a company that does business in New Jersey, each appellant is subject to the New Jersey Corporation Business Tax ("CBT"), a franchise tax measured by a corporation's "entire net income." The interaction of those two tax schemes, each of which is summarized below, gives rise to the present controversy.

Under the CBT, New Jersey taxes an apportioned share of a corporation's "entire net income" from all sources, both in-state and out-of-state. It accordingly required each appellant to include in its preapportionment tax base the income contributed by its out-of-state oil production activities. This Court held in *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980), that a non-production state could lawfully tax an apportioned share of income derived from an integrated company's out-of-state oil production, and no appellant objects to that aspect of New Jersey's tax scheme.

But here is the rub. Unlike Wisconsin in the *Exxon* case, New Jersey includes in its tax base the out-of-state oil production income but leaves behind a significant portion of the offsetting oil production costs. It reaches that result by defining "entire net income" to preclude a deduction for the billions of dollars in WPT payments that appellants and others have made to the federal government since 1980. The WPT is a production cost necessarily incurred in the "removal" of crude oil—an activity that takes place, and can only take place, exclusively outside New Jersey. No comparable cost incurred on account

[2] U.S. Department of Energy, *Petroleum Supply Annual 1986*, Vol. I, Table 9, at 31 (May 1987); U.S. Department of Commerce, *State and Metropolitan Area Data Book 1986*, at 585.

of any in-state activity is accorded similarly disadvantageous tax treatment under the CBT.

Appellants contend that the New Jersey tax scheme, by thus selecting for disallowance a major cost of exclusively out-of-state oil production, has two fundamentally impermissible consequences. First, it generates a geographically asymmetrical "entire net income" base, composed of income from everywhere less *all* costs incurred within New Jersey but only *some* costs incurred outside New Jersey. Because the state starts with a geographically unbalanced net income base, its otherwise unobjectionable apportionment formula necessarily subjects to New Jersey taxation a greater portion of appellants' multistate income than is fairly attributable to the business done there.

Second, the New Jersey statute unlawfully discriminates against interstate commerce by imposing unique tax burdens on a class of taxpayers solely because they engage in a form of business activity conducted exclusively outside the state's borders. Although the discrimination does not favor an identical activity within New Jersey—no crude oil is produced there—it nonetheless impairs free trade by assigning a disproportionate share of the local tax burden to a segment of interstate commerce, thereby saddling it with a competitive handicap in the domestic New Jersey market.

Before describing the state court's handling of these issues, we briefly outline the relevant features of the WPT and the CBT.

A. The Windfall Profit Tax

1. *Background*

During the 1970s, the domestic oil industry was subject to an elaborate system of price and allocation controls. The system was gradually dismantled between 1975 and 1981, when all regulatory authority was terminated. In late 1979 and 1980, shortly after President Carter began phasing out crude oil price controls, the world market price for crude oil soared, and the President and Congress became acutely sensitive to the political implications of allowing domestic producers to obtain the full benefit of the substantially higher uncontrolled prices. In the Crude Oil Windfall Profit Tax Act of 1980, I.R.C. §§ 4986 *et seq.*, Congress addressed that concern by imposing "an excise tax on the additional revenue resulting from decontrol." *United States v. Ptasynski*, 462 U.S. 74, 76 (1983). "Without such a tax, decontrol probably could not [have gone] forward." Staff of Jt. Comm. on Taxation, *General Explanation of the Crude Oil Windfall Profit Tax Act of 1980*, at 26 (Jt. Comm. Print 1981) [hereinafter *General Explanation*].

The tax was intended to reserve for the federal treasury a "fair share" of the economic benefits of deregulation, thereby achieving "greater equity in the distribution of the gains from higher oil prices." S. Rep. No. 394, 96th Cong., 1st Sess. 6 (1979). Congress sought to "strike the appropriate balance between tax receipts that could be used for public investment or redistribution and industry incentives to increase domestic oil production." Cong. Budget Office, *The Windfall Profits Tax: A Comparative Analysis of Two Bills* xv (Nov. 1979); *see* S. Rep. No. 394, *supra*, at 6-7; H.R. Rep. No. 304, 96th Cong., 1st Sess. 4-5 (1979); *General Explanation* 6, 26.

2. *Incidence, Measure, and Tax Rate*

By its terms, the WPT is "[a]n excise tax . . . on the windfall profit from taxable crude oil removed from the premises during each taxable period." I.R.C. § 4986(a). The event that triggers the tax is the removal of a barrel of crude oil from the producing premises. A barrel is "removed" when it is brought to the surface and "physically transported" away from the "immediate vicinity of the well." Treas. Reg. § 51.4996-1(d)(1). If the refining process begins before the barrel is physically removed

from the premises, it is "treated as removed on the day such manufacture or conversion begins." I.R.C. § 4988 (c) (4) (A).

The WPT thus operates as a transactional tax. Liability attaches upon removal of each barrel of crude oil regardless of what happens to that barrel thereafter. *See* H.R. Conf. Rep. No. 817, 96 Cong., 2d Sess. 106 (1980); S. Rep. No. 394, *supra*, at 66; H.R. Rep. No. 304, *supra*, at 43. The producer must pay the tax even if the removed barrel is subsequently lost or for any other reason fails to yield income to the producer.

The measure of the tax—the so-called "windfall profit" —is likewise linked to the physical act of removing a barrel of crude oil. In simple terms, the "windfall profit" is the portion of each barrel's value, determined at the time and place of removal, that is attributable to federal price decontrol. This decontrol increment is computed separately for each barrel and is equal to the "removal price" of the barrel less the sum of its "adjusted base price" and the "severance tax adjustment." § 4988(a).

If the barrel is removed after a sale, the removal price is the actual sales price. § 4988(c) (1). If the barrel is removed prior to sale (for example, if it is transported to the producer's refinery for processing), the removal price is the "constructive sales price"—generally "the representative market or field price of the oil" before removal from the premises. § 4988(c) (3); Treas. Reg. § 1.613-3(a). The "adjusted base price" is the approximate price, adjusted for inflation, at which the barrel would have been sold in 1979 (before price decontrol). § 4989(a). The "severance tax adjustment" is the amount by which any state severance tax imposed on a barrel exceeds the severance tax that would have been imposed if the barrel had been valued at its adjusted base price. § 4996(c).

The Act divides domestic crude oil into three tiers and assigns to each an adjusted base price and a tax rate ranging from 30 to 70 percent. I.R.C. §§ 4987(b), 4989, 4991. The amount of tax with respect to each barrel of crude oil is computed by multiplying the "windfall profit on such barrel" by the applicable tax rate. § 4987(a).

3. *"Net Income Limitation"*

Congress included in the Act a "net income limitation" ("NIL") designed "[t]o prevent the tax from burdening high-cost properties." S. Rep. No. 394, *supra*, at 29; H.R. Rep. No. 304, *supra*, at 2. Under the NIL, the "windfall profit" on a barrel may not exceed "90 percent of the net income attributable to such barrel." § 4988(b) (1).

"Net income" for purposes of the NIL is a term of art that differs materially from the ordinary meaning of the phrase. First, it refers, not to the producer's overall net income from operations, but rather to its per barrel "taxable income from the property." § 4988(b) (2). A producer may have many properties, some profitable and others unprofitable, depending on the acquisition, development, and operating costs of each. "Taxable income from the property," and therefore the NIL for each barrel, must be computed separately for each such property, and losses on one do not offset gains on another. Treas. Reg. § 51.4988-2(b) (1) (i). Consequently, a producer may have, in the same tax year, substantial WPT liability despite having no taxable income for federal income tax purposes.

Second, "income" for NIL purposes does not depend on realization. Like the "removal price," it is computed on the basis of a "constructive sales price" for each barrel removed prior to sale. § 4988(b) (3); Treas. Reg. § 1.613-3(a). The constructive price is used regardless of how much (if any) income is later realized on that barrel.

In sum, although the NIL can limit the amount of a producer's WPT liab[illegible] it does not affect the fundamental character of the WPT as a per barrel transactional tax on specific events that occur at an identifiable time and place.

4. *Federal Income Tax Treatment*

For federal income tax purposes, WPT payments are treated by most companies as inventoriable production costs under I.R.C. § 471. When a company sells crude oil or refined products, it transfers its WPT and other inventoriable costs out of inventory as "costs of goods sold," thereby matching them with the sales proceeds in determining gross income. Alternatively, some taxpayers deduct WPT payments in the year paid either as "ordinary and necessary" business expenses under I.R.C. § 162 or as taxes under I.R.C. § 164, which specifically allows a current deduction for WPT payments.[3]

In assessing the federal tax impact of the WPT, Congress assumed that WPT payments also "generally would be deductible under State income taxes." H.R. Rep. No. 304, *supra*, at 9; *see* H.R. Conf. Rep. No. 817, *supra*, at 163; S. Rep. No. 394, *supra*, at 9; *General Explanation* at 9.

B. The New Jersey Corporation Business Tax

New Jersey imposes an annual tax (the CBT) measured by the "entire net income" of each corporation that does business in the state. N.J. Stat. Ann. § 54:10A-5(c) (West 1986). If a corporation does business both within and without the state, the CBT is imposed on the portion of the corporation's "entire net income" that is attributable to New Jersey under a three-factor apportionment formula representing New Jersey's share of the corporation's total property, receipts, and payroll. *Id.* § 54:10A-6.[4]

[3] We occasionally use "deduction" in this brief in the broadest sense to embrace any item subtractible either from gross receipts to determine gross income or from gross income to determine taxable income.

Federal taxable income is the starting point for determining "entire net income" under the CBT. A taxpayer's "entire net income shall be deemed prima facie to be equal in amount to the taxable income, before net operating loss deduction and special deductions, which the taxpayer is required to report to the United States Treasury Department for the purpose of computing its federal income tax." *Id.* § 54:10A-4(k).

The statute specifies—in what the New Jersey Supreme Court referred to as the "add-back" provision (J.S. App. 2a)—that certain federal deductions must be "added back" to federal taxable income for purposes of the CBT. One of the add-back items is a category of federal taxes to the extent deducted on the federal return. The statute provides that "[e]ntire net income shall be determined without the exclusion, deduction or credit of . . . [t]axes paid or accrued to the United States on or measured by profits or income." N.J. Stat. Ann. § 54:10 A-4(k)(2)(C) (West 1986).[5]

[4] For the years in issue, the New Jersey CBT imposed a concurrent tax on a similarly apportioned share of a corporation's "entire net worth." N.J. Stat. Ann. § 54:10A-5(a) (West 1986). The application of the net worth tax is not at issue in these appeals.

[5] The add-back provision operates to adjust the federal starting point. It therefore reaches only items that are deductible in computing federal taxable income. Because federal income tax paid or accrued in a particular year is not deductible in computing federal taxable income for that year, it need not be "added back" in computing New Jersey "entire net income." *Cf. Texaco, Inc. v. Director, Division of Taxation*, 4 N.J. Tax 63, 66 (1982) ("'entire net income' . . . is identical with federal taxable income" except as specifically adjusted by statute; federal minimum tax for tax preferences is therefore not excludable in computing New Jersey "entire net income"). New Jersey's federal tax add-back provision consequently had been dormant prior to this litigation.

Many states employ comparable provisions denying deductions for state or federal income tax payments. The provisions are intended to prevent erosion of a state's net income tax base through the deduction of similar taxes levied by other jurisdictions on the same base.

C. The Proceedings Below

1. *The Assessments*

At issue in this litigation are the 1980 CBT returns filed by all of the appellants and the 1981 CBT returns filed by five of the appellants.[6] Each appellant, in computing its New Jersey "entire net income," adjusted its federal taxable income in accordance with the requirements of N.J. Stat. Ann. § 54:10A-4(k) (West 1986). No appellant added back WPT costs to federal taxable income. J.A. 16. All considered the WPT to be a federal excise or severance tax imposed on the production of crude oil and measured by the value of the crude oil at the wellhead, not a tax on or measured by corporate income or profit within the scope of the New Jersey add-back provision.

The Director of the Division of Taxation, New Jersey Department of the Treasury, issued CBT deficiency assessments to appellants (resulting in certain cases in the reduction or disallowance of refunds requested because of overpayments). The Director expressly based the assessments and refund denials on the failure of appellants to add back their WPT payments in computing "entire net income." Each appellant filed a protest. After conferences with the appellants, the Director issued final determination letters denying the protests. J.A. 16-17.

The add-back of WPT payments made a "substantial difference" (J.S. App. 44a) to each of the appellants,

[6] The state has deferred final action, pending the outcome of this litigation, on the 1981 returns filed by the other eight appellants and on the subsequent years' returns filed by all but one of the appellants.

increasing their New Jersey tax liability by an average of 22 percent in tax year 1980 (even though federal price controls were still largely in place) and 260 percent in tax year 1981 (when price controls were terminated). The amount and the percentage of each appellant's increased tax liability resulting from the add-back of WPT are tabulated in Appendix A to this brief, *infra*, at 1a.

2. *The Litigation*

a. Each appellant filed a complaint in the Tax Court of New Jersey challenging the deficiency assessment or refund denial. The litigation raised essentially two issues: (1) whether the WPT falls outside the scope of the New Jersey add-back provision because it is not a tax "on or measured by profits or income," and (2) if the WPT is within the scope of the add-back provision as construed, whether the statute, by denying an offset for costs incurred solely on account of activities conducted exclusively outside New Jersey, conflicts with the United States Constitution.

The Tax Court rejected appellants' claims on both issues. J.S. App. 43a-49a. It emphasized, in denying reconsideration, that its construction of the add-back provision turned, not on "whether the WPT *was in fact* a tax on or measured by profits or income," but rather on "what the [state] Legislature perceived it to be." J.S. App. 57a (emphasis in original).

b. On appeal, the Appellate Division of the Superior Court reversed. It determined that, "[b]ecause the WPT is payable without regard to the profitability of the oil producers' overall business activities," it "is not a tax on or measured by profits or income" and thus does not fall within the add-back provision. J.S. App. 39a, 42a. That provision's "purpose," the Appellate Division noted, is "to preserve undiluted for state taxation the same tax base upon which federal income taxes were computed." J.S. App. 41a. The provision "should not be

read to include legitimate business expenses," such as WPT costs, because adding such expenses back to the tax base could "create tax liabilities in spite of overall losses," contrary to the fundamental design of the CBT. *Id.* In light of its construction of the statute, the Appellate Division had no need to address the constitutional issues.

c. The New Jersey Supreme Court reversed the judgment of the Appellate Division and reinstated the judgment of the Tax Court. The Supreme Court acknowledged that the WPT, unlike the CBT, is "imposed on production at the wellhead" and that its measure is not a company's "overall net profits or income" but rather the incremental value of a barrel of crude oil at the wellhead resulting from decontrol. J.S. App. 5a-6a. It accordingly recognized that the WPT is not "directed at the same income base as the C.B.T." J.S. App. 33a. Nevertheless, based on "the principle of probable legislative intent" (J.S. App. 10a), it concluded that the WPT fell within the add-back provision.

Even without adding back the WPT deduction, New Jersey would enjoy a significantly expanded tax base, and materially higher tax revenues, because of the impact of price decontrol on the net income of crude oil producers. The New Jersey Supreme Court nonetheless theorized that, "if the Legislature had anticipated the enactment of the W.P.T., it would have been concerned" that the "deductibility of the W.P.T. would shrink the State's tax base." J.S. App. 11a. For that reason, according to the Court, "the Legislature probably would have viewed the W.P.T. as a tax on the 'profits' and 'income' of oil companies, thereby avoiding a revenue loss." *Id.*

The Court next considered the constitutionality of the statute as interpreted. First, it held that disallowing a deduction, even for costs incurred solely on account of out-of-state activities, does not implicate the territorial

limitations on state taxing power imposed by the Due Process Clause. So long as the state employs a constitutionally permissible "three-factor apportionment formula," it is "entitled to include" in the tax base of a unitary business "100% of [its] entire net income." J.S. App. 33a. Implicit in the Court's holding is the view that nothing in the Constitution limits the manner in which the state defines "entire net income"—that it may require add-backs, or disallow deductions, without regard to any resulting geographical imbalance in the tax base.

Second, the Court held that "[d]enial of the W.P.T. deduction does not violate the commerce clause because it does not favor in-state over out-of-state economic activity" and is "not based on the interstate nature of plaintiffs' businesses." J.S. App. 34a. The Court did not address appellants' contention that, under the Court's construction of the CBT, integrated companies, solely because they engage in the exclusively out-of-state activity of oil production, are subjected to a discriminatorily higher effective tax burden than are all other New Jersey taxpayers, including independent marketers with whom the integrated companies directly compete in New Jersey.

Finally, the Court concluded that the disparate treatment of integrated companies and independent marketers does not violate the Equal Protection Clause. According to the Court, integrated companies are in a different class because "they produce crude oil and pay the W.P.T." and because they alone benefited "from the decontrol of crude oil prices." *Id.* It did not explain why the measure of the producer's benefit under that analysis may include not only the producer's but also the federal treasury's share of those higher prices.

d. These appeals followed. On November 9, 1987, the Court invited the Solicitor General to submit a brief expressing the views of the United States. J.A. 42. On

May 16, 1988, after receipt of the Solicitor General's brief, the Court noted probable jurisdiction and consolidated the appeals. J.A. 43-44.

SUMMARY OF ARGUMENT

I

A.

A state may tax only that portion of a multistate company's net income that is fairly attributable to its business activities within the jurisdiction. *Butler Bros. v. McColgan*, 315 U.S. 501, 506 (1942). Under the formula apportionment method approved by this Court, a taxing state first computes the company's total net income from all sources and then apportions to itself a share of that amount under a formula that reasonably approximates the in-state ratio of the company's income-generating activities. *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 165, 169 (1983).

To avoid taxing a disproportionate share of multistate net income, the state must apply a geographically fair apportionment formula to a geographically neutral preapportionment tax base. If either component embodies an inherent geographical bias—for example, if the formula automatically gives greater weight to in-state than to out-of-state business activities, or if the preapportionment base is intrinsically slanted to include a larger percentage of out-of-state than in-state income—the state will necessarily apportion to itself more of the taxpayer's multistate income than can fairly be attributed to its business within the state, in violation of both the Due Process Clause and the Commerce Clause.

1. New Jersey uses a geographically benign three-factor apportionment formula to which no one here objects. But it applies that formula, in the case of crude oil producers, to a geographically asymmetrical preapportionment tax base. While New Jersey includes in the base all the income derived from appellants' exclusively out-of-state crude oil production activities, it simultaneously disallows, under its statutory "add-back" provision, an offset for a substantial portion of the associated costs incurred solely on account of those activities.

Unlike most commonly deductible business expenditures, which are as likely to be incurred inside as outside any particular state, windfall profit tax outlays are both site-specific and geographically localized. They are incurred only in the "removal" of crude oil—an activity that takes place, and can only take place, outside the State of New Jersey. No comparable in-state outlay is treated with the same disfavor as WPT costs. By thus singling out for disallowance this large class of necessarily extrastate costs, New Jersey artificially inflates appellants' preapportionment net income, automatically incorporating a disproportionate share of out-of-state values. Because the preapportionment base is geographically unbalanced, the amount apportioned to New Jersey by its formula is necessarily exaggerated. The result is that New Jersey inevitably taxes a larger share of appellants' multistate net income than is fairly attributable to their business within the state.

2. The New Jersey Supreme Court wrongly determined that nothing in the federal Constitution confines the state's allowance or disallowance of income tax deductions. None of the state's theories supports that conclusion.

First, neither the fairness of a state's three-factor apportionment formula nor the doctrine of "legislative grace" can insulate from constitutional scrutiny the systematic geographical tailoring of the state's preapportionment tax base. If that base is defined in a geographically uneven fashion, whether through the selective granting or denial of deductions or otherwise, even the fairest apportionment formula is impotent to prevent the improper taxation of extraterritorial values.

Second, while this Court in *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980), authorized a non-production state to include in an integrated oil company's preapportionment tax base income derived from out-of-state oil production, it nowhere implied that the state could strip the income from the associated costs, taxing the former while ignoring the latter. The unitary stream of multistate income carries with it a unitary stream of costs. If a state chooses to tax an apportioned share of the income, it must treat the costs in a geographically even-handed manner.

3. New Jersey's theory would undermine formula apportionment. If every state were free to gerrymander its preapportionment tax base, incorporating out-of-state income while excluding the out-of-state costs incurred in generating that income, taxing authorities could seek to identify forms of business activity conducted exclusively or overwhelmingly outside the state's borders and then shape allowable deductions to disfavor the costs incurred on account of those activities. The effect would be to export the local tax burden, increasing the state's tax collections at the expense of extrastate business.

The circumstances of this case illustrate the danger. By construing its add-back provision to disallow a large class of site-specific, exclusively out-of-state costs, New Jersey has necessarily skewed to a significant degree the tax base of every affected taxpayer. This Court has never required mathematical precision in the apportionment of multistate income, and a closer case, involving a less pronounced geographical disparity, might present delicate line-drawing problems that this case does not. Contrary to New Jersey's assertion, however, that is no reason to give the states license to nullify the fair apportionment requirement by manipulating the preapportionment tax base.

B.

In form, the add-back provision is part of New Jersey's corporate net income tax. In economic reality, it operates as a New Jersey version of the federal windfall profit tax, mathematically increasing each producer's New Jersey tax liability by an "apportioned" percentage of its federal WPT liability. Viewed in that light, the add-back provision effectively levies a transactional tax that exceeds New Jersey's taxing jurisdiction.

The removal of crude oil, like the severance of coal, can be taxed directly only by the state within which it occurs. *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 617 (1981). Because no crude oil is removed from premises located in New Jersey, the state lacks nexus to tax the removal activity. Likewise, New Jersey may not impose a tax that is effectively measured by the value of crude oil at the time and place of removal, because that value "bears no relationship to the taxpayers' presence or activities" in New Jersey. *Id.* at 629. New Jersey should not be permitted to achieve indirectly, under the cover of an income tax, what it is forbidden to do directly.

II

A.

New Jersey's add-back provision, as construed, impermissibly discriminates against a category of exclusively out-of-state business operations. Although the provision nominally reaches WPT costs regardless of where they are incurred, they are in fact incurred only outside the state's borders. Facial neutrality is no defense under the Commerce Clause and the Equal Protection Clause when a tax classification operates, as New Jersey's does, in a geographically discriminatory manner.

B.

1. The New Jersey Supreme Court mistakenly concluded that constitutional protections are inapplicable if the disfavored business activity has no identical in-state

counterpart. When a company that operates in several states is subjected to a disproportionate tax burden in one state solely because of its business operations in another, the effect is to penalize it for crossing the taxing state's borders, thereby erecting economic obstacles to interstate trade. If every state were free, as New Jersey claims to be, to disfavor business operations that are performed exclusively outside the taxing jurisdiction, it would be only a matter of time before multistate companies would confront a balkanized confederacy of retaliatory tax regions, contrary to the central purposes of the Commerce Clause.

2. The discriminatory effect of the add-back provision provides a direct competitive advantage to non-producer independent petroleum marketers with whom the integrated companies directly compete in New Jersey. Under the state's taxing scheme, each integrated company must add back to its federal taxable income a significant portion of its out-of-state oil production costs, while its non-producer competitors are permitted to deduct in full their cost of acquiring petroleum products.

Where, as here, all members of the disfavored class are necessarily interstate operators, it is immaterial that some members of the favored class may also be interstate operators. The New Jersey scheme unlawfully exacts from a segment of interstate business more than a fair share of the local tax burden. That result is forbidden irrespective of how the resulting competitive benefits are allocated.

ARGUMENT

I. THE NEW JERSEY STATUTE, AS CONSTRUED AND APPLIED, IMPERMISSIBLY TAXES EXTRA-TERRITORIAL VALUES

It is fundamental that, "[u]nder both the Due Process and the Commerce Clauses of the Constitution, a State may not, when imposing an income-based tax, 'tax value earned outside its borders.'" *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 164 (1983), *quoting ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982). In the case of a multistate company that derives its income from more than one jurisdiction, a state may tax only that portion of the company's net income that is "'reasonably attributable' to the business done there." *Butler Bros. v. McColgan*, 315 U.S. 501, 506 (1942).

One way for a state to determine the "locally taxable income" of a multistate business is by means of "formal geographical or transactional accounting." *Container*, 463 U.S. at 164. But when a company's "intrastate and extra-state activities form[] part of a single unitary business," the Court has recognized that "separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale." *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 438 (1980); *accord Container*, 463 U.S. at 164-65.

For that reason, the Court has long permitted states to tax the net income of a multistate company under the "unitary business/formula apportionment method." *Id.* at 165. That method uses a two-step procedure for deriving locally taxable income. First, the state must determine the company's preapportionment tax base by "defining the scope of the 'unitary business'" and calculating its total net income from all sources. *Id.* Second,

the state must "then apportion[] the total income of that 'unitary business' between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction." *Id.*

New Jersey uses the unitary business/formula apportionment method and applies the common three-factor apportionment formula. A corporation that does business both inside and outside New Jersey is subject under the CBT to a tax of nine percent on that portion of its "entire net income"—defined as "total net income from all sources"—that is "allocable to this State." N.J. Stat. Ann. §§ 54:10A-4(k), 54:10A-5(c) (West 1986). The state's "allocation factor" is the average of three fractions representing the in-state ratios of the taxpayer's total property, receipts, and payroll. *Id.* § 54:10A-6. New Jersey's apportionment formula can be expressed as follows:

$$\text{Entire net income} \times \frac{\left(\frac{\text{NJ property}}{\text{All property}} + \frac{\text{NJ receipts}}{\text{All receipts}} + \frac{\text{NJ payroll}}{\text{All payroll}}\right)}{3}$$

$$= \text{NJ taxable income}$$

Formula apportionment does not permit a state to reach "extraterritorial values." *Mobil*, 445 U.S. at 442; *Butler Bros. v. McColgan*, 315 U.S. at 507. On the contrary, the method is permissible only insofar as it produces at least a "'rough approximation' of the corporate income that is 'reasonably related to the activities conducted within the taxing State.'" *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207, 223 (1980), *quoting Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978). In the words of Justice Holmes, "[t]he purpose is not . . . to open to taxation what is not within the State," but only to estimate "the true value of the things within it." *Wallace v. Hines*, 253 U.S. 66, 69 (1920).

The Court has synthesized these territorial limitations on state taxing power in a four-pronged test, developed principally in Commerce Clause cases but embodying Due Process standards as well. *See* 1 J. Hellerstein, *State Taxation* ¶ 4.8, at 123 (1983). To pass constitutional muster, a state tax, including one that employs the unitary business/formula apportionment method, (1) must be "applied to an activity with a substantial nexus with the taxing State," (2) must be "fairly apportioned," (3) must "not discriminate against interstate commerce," and (4) must be "fairly related to the services provided by the State." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

In applying the *Complete Auto* test, the Court is particularly vigilant to the dangers posed by geographically "tailored" state taxes—including those that are facially neutral but that effectively apply "different rates for different types of business" or that "change with the nature of the corporate activity involved." *Id.* at 288 n.15. The Court has recognized that "[a]ny tailored tax of this sort creates an increased danger of error in apportionment, of discrimination against interstate commerce, and of a lack of relationship to the services provided by the State." *Id.* Accordingly, "[a] tailored tax, however accomplished, must receive the careful scrutiny of the courts to determine whether it produces a forbidden effect on interstate commerce." *Id.*

As applied to vertically integrated oil companies, the New Jersey tax is geographically tailored. It singles out for uniquely disadvantageous treatment a substantial cost incurred on account of a business activity—crude oil production—that is performed only outside New Jersey. In its practical operation, the tax produces precisely the "forbidden effect" of which *Complete Auto* warned, violating all four prongs of the test.

Putting to one side for a moment the question of discrimination, we address in this section the three terri-

toriality prongs of the *Complete Auto* standard: fair apportionment, nexus, and fair relationship.

A. New Jersey's Construction of its Add-Back Provision Geographically Distorts the Tax Base of Crude Oil Producers and Results in an Unfairly Apportioned State Tax

1. Geographical Tailoring of Deductions Produces an Inherently Asymmetrical Apportionment

The fairness of apportionment depends not only on the state's apportionment formula but also on the makeup of the preapportionment tax base to which the formula is applied. If a state defines taxable income in a manner that incorporates out-of-state values disproportionately, even the fairest apportionment formula will necessarily yield a geographically skewed and therefore improper result.

It follows that if, as here, a state imposes a tax based on net income—thereby allowing deductions from gross receipts—it cannot, consistent with constitutional limitations, tailor the allowable deductions geographically either (1) by permitting deductions for costs incurred only inside the state, or (2) by disallowing deductions for costs incurred only outside the state. Of course, the vast majority of business expenditures—such as wages, depreciation, bad debts, and interest expense—are no more likely to be incurred outside than inside any particular state. A taxing jurisdiction is free to permit or deny deductions for such geographically dispersed costs without risk of creating an inherently asymmetrical tax base.

But the circumstances here are quite different. Windfall profit tax liability is incurred solely on account of the removal of crude oil from producing premises located outside New Jersey. By defining "entire net income" to forbid a deduction for this large and distinct class of exclusively out-of-state costs, New Jersey automatically incorporates in each appellant's preapportionment tax

base a disproportionate component of out-of-state values. When New Jersey applies its standard three-factor apportionment formula to this geographically unbalanced tax base, it effectively subjects to local taxation a percentage of income that is necessarily greater than can fairly be attributed to in-state business activities.

The state does not dispute the central premises of our argument. It conceded at the jurisdictional stage of this case that the WPT is a "cost" "attributable to oil production" (Motion 14),[7] that "there is no crude oil production in New Jersey" (*id.* at 21), and that appellants' WPT costs therefore "have a geographic source outside" New Jersey. *Id.* at 14. It acknowledged that the effect of denying a WPT deduction is to "augment appellants' entire net income." *Id.* at 19.

New Jersey asserts, however, that the Court should provide no remedy under the fair apportionment prong of *Complete Auto* unless appellants can demonstrate that "denial of a deduction for the WPT results in an irrational, arbitrary *amount* of their income being subjected to tax." Motion 14 (emphasis in original). Even if that were the appropriate standard, the record here would amply satisfy it. As reflected in the table appended to this brief, New Jersey, through the operation of its addback provision, dramatically increased the amount of appellants' taxable income and state tax liability. App. A, *infra*, at 1a.[8]

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[7] "Motion" refers to the Motion to Dismiss or Affirm in No. 87-453.

[8] By denying a WPT deduction, New Jersey was able to increase the tax liability of these 13 appellants for tax year 1980 alone (when crude oil price controls remained largely in effect and WPT payments were accordingly limited) by $10.1 million, an increment of 22 percent. App. A, *infra*, at 1a. In 1981, as WPT payments accelerated following the termination of price controls, the state tax repercussions were even more striking. For just the five appellants whose 1981 tax year is at issue, denial of the WPT deduc-

More fundamentally, however, the flaw in New Jersey's scheme is qualitative, not merely quantitative. When a taxpayer complains about a particular application of an otherwise structurally sound state apportionment mechanism, it may properly be held to a high standard of proof concerning the degree of distortion. *See Container*, 463 U.S. at 170; *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 134 (1931). But where, as here, a state's mechanism is structurally defective, so that it necessarily distorts the net income base of a discrete class of substantial taxpayers, the standard is different. As the Court recognized in *Hans Rees*, a geographically tailored scheme may be invalidated at the threshold on the ground that it is "intrinsically arbitrary," without the need for individualized scrutiny of each taxpayer's particular circumstances. *Id.* at 133. *Accord Bass, Ratcliff, & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271, 283 (1924); *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920).

To take a simple example of such geographical tailoring, suppose that New Jersey, instead of disallowing a deduction for WPT costs, had required each integrated oil company to double the numerator of its payroll fraction under the CBT's apportionment formula. The result in every case would be to increase artificially each company's New Jersey allocation factor, thereby necessarily imputing to the state more than its fair share of the company's multistate net income. No further inquiry is required to conclude that such a formula would be "intrinsically arbitrary" under *Hans Rees*.

Alternatively, suppose that New Jersey had excluded from the property fraction any consideration of the value of oil production property. Since there is no oil production property in New Jersey, the effect of such a rule would be to reduce the denominator of every integrated company's property fraction, thereby increasing its allocation factor and inflating its post-apportionment income subject to New Jersey taxation. One need not examine the formula's quantitative application to any particular oil company to know that it will necessarily produce a geographical imbalance in the company's taxable income.

A similar analysis should apply where, as here, the state employs a geographically benign apportionment formula but introduces an inevitable geographical bias into its definition of net income. Because each company's post-apportionment taxable income is computed by multiplying its preapportionment "entire net income" by its New Jersey "allocation factor," the impact on taxable income is the same whether the geographical tailoring occurs in the numerator or denominator of an allocation fraction or in the composition of the preapportionment tax base. In each case, the tailoring is "intrinsically arbitrary" because it creates what this Court characterized in a related context as "an *automatic* 'asymmetry'" in every affected company's post-apportionment taxable income. *Container*, 463 U.S. at 195 (emphasis in original).[9]

tion produced an aggregate increase in New Jersey tax liability of $12.5 million, an increment of 260 percent. *Id.* The impact on some individual companies was particularly egregious. In the case of Amerada Hess, for example, disallowance of the WPT deduction raised its New Jersey tax liability for 1981 from about $860,000 to $7.6 million, an increase of 775 percent. *Id.*

The full impact of the decision below, of course, is not limited to these appellants or to these two tax years. At the jurisdictional stage, New Jersey itself represented that, just for the years 1980 through 1984, the "approximate revenues attributable to denying a deduction for the WPT to these and other producers of crude oil" totaled $88.5 million, excluding deficiency interest. Motion 11 n.8.

[9] As the Solicitor General correctly observed, "because the [New Jersey] tax liability is calculated by multiplying 'entire net income' by the apportionment fraction by the tax rate, the same percentage increases in tax liability could have been achieved by leaving the 'entire net income' base unchanged but increasing the apportionment fraction by the same percentages." U.S. Br. 23 n.24. Appendix

2. *A State's Treatment of Income Tax Deductions Is Not Immune From Constitutional Scrutiny*

The New Jersey Supreme Court ruled, in effect, that the federal Constitution imposes no restraints at all on the state's treatment of income tax deductions. J.S. App. 33a-34a. Its brief discussion of that issue suggests three possible theories.

First, the Court apparently assumed (J.S. App. 33a) that, if a state correctly determines the scope of a unitary business and applies an acceptable three-factor apportionment formula, nothing in the Constitution prevents it from defining taxable income in any way it sees fit, even if the definition necessarily produces gross geographical distortions. That view eviscerates the fair apportionment requirement. It would be pointless to insist on a geographically neutral apportionment formula if the state were free to apply it to a geographically distorted income base.

In striking down New York's geographically discriminatory tax credit in *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984), this Court held that "[n]othing about the apportionment process releases the State from the constitutional restraints that limit the way in which it exercises its taxing power over the income within its jurisdiction." *Id.* at 398-99. A similar principle should apply here as well. The fairness of an apportionment formula should give a state no greater license to tamper in a geographically selective manner with a taxpayer's preapportionment net income base than to adjust in a geographically discriminatory manner its post-apportionment tax liability.

B to this brief, *infra*, at 2a, tabulates for the years in issue both the actual New Jersey allocation factor for each company and the effective allocation factor that New Jersey would have had to use to accomplish the same increases in the company's tax liability without adding back WPT payments. Compare App. A, *infra*, at 1a.

Second, the New Jersey Supreme Court may have believed (*see* J.S. App. 33a-34a), as the state argued below (App. Div. Br. 21-23, 117-18), that deductions are solely a matter of legislative grace. But even if a state were free to disallow all deductions—an assumption that raises a different set of constitutional questions [10]—it would not follow that it could permit some and deny others without constitutional constraint. "While appearing to tax income by a reasonable formula of apportionment, a state can unfairly enlarge its share [of multistate income] by refusing to allow commonly permitted deductions." *Developments in the Law—Federal Limitations on State Taxation of Interstate Business*, 75 Harv. L. Rev. 953, 967 (1962). Consequently, once a state determines to allow deductions from gross receipts, it must do so on a geographically neutral basis. Were it otherwise, the fair apportionment standard could be evaded by the simple expedient of carving out deductions that effectively favor in-state or disfavor out-of-state activities.

[10] As the Solicitor General noted, "as more and more costs are disallowed, the preapportionment figure moves away from 'net income' and toward gross revenues." U.S. Br. 21 n.21. Although this Court "has not generally considered whether a State may tax a unitary business's gross receipts by multiplying company-wide receipts by ratios like that used by New Jersey (payroll, receipts, property)," the Solicitor General believes that "[a]ny such tax would create a risk of multiple taxation, because the in-State receipts are fully taxable by the State where they are received." *Id.* In his view, moreover, "the practical justification for using an apportionment formula is considerably weaker for gross receipts than for income. That justification rests to a large degree on the difficulty of identifying the State in which *profits* (the net of revenues over costs) are generated . . . ; but receipts are one of the standard elements of the three-factor apportionment fraction precisely because their location is objectively measurable with reasonable certainty." *Id.* (emphasis in original). The Court need not grapple with these questions here because, in the Solicitor General's words, "[t]hese cases involve only a problem of geographic skewing." *Id.*

Certainly a state could not, without exceeding its territorial taxing jurisdiction, single out an exclusively out-of-state business activity and require a taxpayer to double the income from that activity in computing its taxable net income. The state should have no greater latitude, under the heading of legislative grace, to deny a deduction for half of the costs incurred on account of an out-of-state activity. Halving out-of-state deductions, no less than doubling out-of-state income, distorts the preapportionment tax base, violates the fair apportionment requirement, and "project[s] the taxing power of the state plainly beyond its borders." *Nashville, Chattanooga & St. Louis Ry. v. Browning*, 310 U.S. 362, 365 (1940).

This Court in *Westinghouse* rejected a similar attempt to invoke legislative grace. New York sought to justify its geographically discriminatory tax credit on the theory that it "forgives merely a portion of the tax that New York has jurisdiction to levy" (466 U.S. at 398)—in effect, because the state can tax the whole, it should be altogether free to tax any amount less than the whole. The Court held, however, that "it is not the provision of the credit that offends [constitutional limitations], but the fact that it is allowed on an impermissible basis, *i.e.*, the percentage of a specific segment of the corporation's business that is conducted in New York." *Id.* at 406 n.12.

As in *Westinghouse*, the issue here is not whether New Jersey can grant or deny a deduction but whether it can do so "on [a geographically] impermissible basis." *Id.* Here, as in that case, the doctrine of legislative grace provides no shield for the constitutional defect in the state's taxing scheme.[11]

[11] Just a few days ago, the Court rejected yet another claim of legislative grace when it invalidated, under the Privileges and Immunities Clause, Virginia's residency requirement for admission to the bar without examination. *Supreme Court of Virginia v. Friedman*, No. 87-399 (June 20, 1988). The state argued that, because it could lawfully require all bar applicants to pass an examination, its refusal to waive an examination for nonresidents gave rise to no constitutionally cognizable claim. Slip op. at 5-6. That argument is echoed by New Jersey's assertion here that, because the state could tax any amount up to gross receipts, its disallowance of a deduction from gross receipts is not subject to federal constitutional constraints. The Court in *Friedman* held, however, in terms that illuminate the issue here as well, that "[a] State's abstract authority to require from resident and nonresident alike that which it has chosen to demand from the nonresident alone has never been held to shield the discriminatory distinction from the reach of the Privileges and Immunities Clause." Slip op. at 7.

In this Court, New Jersey advances a third, closely related justification for the state court's holding. The state acknowledges that its taxing power is subject to the "territorial constraints of the Due Process Clause" (Motion 2), and it apparently recognizes that its "net income base" must be free of "geographic bias." *Id.* at 14. But its concept of geographic bias is eccentric. Under New Jersey's theory, so long as the starting point for calculating taxable net income does not exceed the total gross receipts of a unitary enterprise, the state's treatment of deductions, no matter what their geographic source may be, "introduces no unconstitutional distortion to the net income base." *Id.* at 15. But the net income base is determined by subtracting allowable deductions from gross receipts. If the deductions are geographically unbalanced, the resulting base will be geographically distorted even if the starting point of gross receipts has been determined on a permissibly neutral basis.

The source of the state's apparent confusion is its reading of *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980). The Court there held that a non-production state may include in the preapportionment tax base of an integrated oil company "income derived from the extraction of oil and gas located outside the State which is used by the [taxpayer's] refining department." *Id.* at 210. New Jersey infers from that holding that it may both include the income from out-of-state oil produc-

tion and simultaneously disregard the associated costs. Motion 14.

That view of the case would convert *Exxon* into a tax collector's bonanza, allowing each jurisdiction to tax out-of-state income unencumbered by out-of-state costs. But nothing in this Court's opinion suggests that a state may properly separate production income from associated production costs, pulling the income into the state while leaving the costs behind. On the contrary, the Court plainly assumed that unitary "costs and charges" were inseparable from unitary income. 447 U.S. at 221.

3. *Requiring Geographical Neutrality in the Definition of Net Income Is Not "Unworkable"*

The state's fallback argument, developed principally in response to the Solicitor General's brief, is that "appellants' proposed doctrine would be totally unworkable." Br. in Resp. to U.S. 7. But it is no more unworkable to insist on geographically neutral tax deductions than to require geographically fair apportionment formulas.

The Court has always recognized that "apportionment with mathematical exactness is impossible" (*Hans Rees*, 283 U.S. at 134) and that some degree of "imprecision" is constitutionally tolerable. *Moorman*, 437 U.S. at 273. It has therefore accorded the states a generous "margin of error" when they apply fundamentally even-handed apportionment principles. *Container*, 463 U.S. at 184. But states should have no greater freedom in their treatment of deductions than in their framing of apportionment formulas to adopt intrinsically unfair schemes that inevitably exaggerate the share of multistate income reasonably attributable to the taxing jurisdiction.

We acknowledge that it may be difficult to craft bright-line tests that clearly distinguish between a geographically tailored and impermissibly skewed tax scheme on the one hand and an inherently fair though tolerably imprecise scheme on the other hand. But there is nothing new

in that. The Court has long instructed that decision-making in this area "requires a case-by-case analysis" (*Westinghouse*, 466 U.S. at 403) where "the result turns on the unique characteristics of the statute at issue and the particular circumstances in each case." *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 329 (1977).

Although the decision of any case naturally has implications beyond the confines of the particular circumstances at issue, the reach of our analysis, as the Solicitor General correctly stated, "is narrowed by several inherent limitations." U.S. Br. 21.

First, our theory "applies only to costs that are properly identified as site-specific, those whose amount increases directly with the level of activity that is identifiably out-of-State." *Id.* The WPT, as a transactional tax, is a cost tied directly to an event—the removal of each barrel of crude oil—that occurs at a specific time and place and only outside New Jersey.

Second, our analysis "depends on an in-State/out-of-State comparison of the incidence of [the out-of-state] cost, so that if the State treats comparable in-State costs in the same manner, there may be no constitutional problem." U.S. Br. 22. If the disfavored class of costs includes a roughly proportional mix of those linked to in-state as well as those linked to out-of-state activities, the state's disallowance of the deduction would be presumptively even-handed and therefore not subject to the charge that it necessarily skews the tax base of every affected taxpayer.

Third, "these cases involve a cost that is incurred exclusively out-of-State, so the Court need not rule on cases involving less stark skewing." U.S. Br. 22. It may be that the principles underlying our analysis should extend as well to costs that are incurred overwhelmingly, even if not exclusively, outside the taxing state's borders. And

some cases may present close questions. But, as the Solicitor General has pointed out, the decision here can be confined to "geographic skewing that is pronounced and systemic, and not limited to particular taxpayers based on the fortuity of the locations of parts of their businesses." *Id.* The standard of "rough approximation" (*Exxon*, 447 U.S. at 223; *Moorman*, 437 U.S. at 273), which has governed the Court's deferential scrutiny of apportionment formulas, can likewise circumscribe any challenge to a state's preapportionment tax base.

Far more dangerous than requiring geographical neutrality in the definition of net income is the alternative proffered by New Jersey. Under its theory, any state would be free, so long as it taxed an amount no greater than apportioned gross receipts, to shape its tax deductions in a manner that inevitably incorporates out-of-state values disproportionately. Revenue-hungry state tax collectors cannot be expected to overlook the opportunity such a rule would provide to export to out-of-state business activities a disproportionate share of the burden of new state tax measures.

Indeed, New Jersey is not the only jurisdiction to have seized on the idea. Although Congress assumed when it enacted the tax that WPT payments "generally would be deductible under State income taxes" (H.R. Rep. No. 304, *supra*, at 9), the $78 billion in WPT liability that crude oil producers have incurred since 1980 [12] has proven to be an inviting target for some state tax authorities. Six other states—either by express statutory provision or by administrative ruling—specifically disallow an income tax deduction for WPT payments.[13] Not surprisingly, all but one of those states,

[12] *Budget of the United States Government, Fiscal Year 1988, Supplement*, Table 17, at 6c-34.

[13] The states are Georgia, Iowa, Minnesota, New York, South Carolina, and Wisconsin. The manner in which each of these

like New Jersey, have no crude oil production at all; the remaining state has only negligible production.[14]

New Jersey's theory, of course, is not confined to WPT costs. The principle it espouses could spawn attempts by non-producing states to withdraw deductions for mineral severance taxes imposed by producing states, thereby increasing the non-producing states' tax revenues at the sole expense of out-of-state business activities. Nor is the theory limited to tax costs or to mineral production. If New Jersey's approach were upheld, each state could target categories of business operations conducted entirely outside its borders and attempt to shape its income tax deductions to magnify the state's share of multistate income derived from those operations. The New Jersey solution would threaten the foundations of formula apportionment by sanctioning state efforts to assign a disproportionate share of the local tax burden to out-of-state economic interests.

states treats WPT payments is summarized in Appendix C to this brief, *infra*, at 5a-10a.

[14] Only in New York is any crude oil produced, and its rate of production—both for the years in issue and currently—averages only about 2,300 barrels per day, or less than three one-hundredths of one percent of the nation's total crude oil production of approximately 8.6 million barrels per day. U.S. Department of Energy, *Petroleum Supply Annual 1986*, Vol. I, Table 9, at 31 (May 1987); U.S. Department of Energy, *Petroleum Supply Annual 1981*, Vol. I, Table 9, at 43 (July 1982); U.S. Department of Energy, *Energy Data Reports: Crude Petroleum, Petroleum Products, and Natural Gas Liquids: 1980*, Table 5, at 12 (December 1981).

Apart from the six states mentioned, during the transition year of 1980, North Dakota, a production state, imposed a ceiling of $1 million on a corporation's deduction of WPT payments. For years after 1980, the North Dakota statute permits a full deduction for WPT. *See* App. C, *infra*, at 8a-9a. In addition, the tax authorities in Kansas, another production state, recently issued assessment notices to at least two companies, asserting the position that WPT payments are not deductible for state income tax purposes. The assessment notices are subject to taxpayer protest and further administrative review.

4. *The WPT Is a Site-Specific Out-of-State Cost Not Comparable to Any In-State Cost for Which New Jersey Denies a Deduction*

New Jersey has acknowledged that the WPT is "a cost which happens to have a geographic source outside" the state. Motion 14. The Solicitor General has likewise concluded that "the windfall profit tax is site-specific in the critical respect—liability for it is as directly related to activity that takes place at a geographically identifiable place as is liability for an ordinary severance tax." U.S. Br. 24.

Under the Solicitor General's analysis, New Jersey would still be free to disallow a deduction for WPT costs without impermissibly skewing the state's preapportionment tax base if such costs were "sufficiently like another in-State outlay whose deduction is also disallowed by the State." *Id.* New Jersey itself points to no comparable "in-State outlay" for which a deduction is denied, and we know of none. In the Solicitor General's view, "the only non-deductible outlay that is (or could be) alleged to be comparable [to the WPT] is federal income tax liability." *Id.* He believes, therefore, that a "determinative question" in this case is "whether the windfall profit tax is more like an ordinary severance tax, whose subtraction New Jersey allows in calculating the 'entire net income' tax base, than it is like the federal income tax, whose subtraction New Jersey does not allow." *Id.*

We agree that the comparison is an apt one, but we think it relates more directly to whether the WPT is in fact an out-of-state cost, a point that is not disputed by New Jersey.[15] In any event, for the reasons suggested by the Solicitor General, we think that the WPT is constitutionally indistinguishable from an ordinary severance tax and fundamentally different from the federal income tax.

[15] A state severance tax—imposed on the severance of crude oil or other minerals from the ground—is the prototype of a site-specific, transactional tax. The federal income tax, by contrast, is the prototype of a levy on bottom-line net income derived from the taxpayer's business activities everywhere. If the WPT, like the federal income tax, were measured by company-wide net income from all operations, New Jersey's disallowance of the deduction would not result in the kind of geographically unbalanced preapportionment tax base of which we complain here. That conclusion would follow, however, not because the income tax would then qualify as an in-state outlay comparable to the out-of-state WPT, but because the WPT under these assumptions would not be an exclusively out-of-state outlay.

We agree with the Solicitor General that the WPT's operating incidence ("removal") and its measure (incremental value at the time and place of removal) are similar to those of a severance tax and unlike those of the federal income tax. U.S. Br. 25. Even with the "net income limitation," WPT liability, like severance tax liability, depends on the value of removed crude oil at the producing property, not on the actual receipt of revenues. U.S. Br. 25-26. Moreover, Congress deliberately cast the WPT as a transaction-based excise tax rather than a company-wide net income tax. U.S. Br. 26-27. The WPT thus operates, like a severance tax, as a "cost[] of earning income," not as a "payment[] out of income earned." U.S. Br. 28.

The dividing line between a severance tax and an income tax in this context is not, in our view, a difficult one to draw. A key question is this. If crude oil removed from the premises is lost in transit to the refinery, is the producer nonetheless liable for the tax? If so, the tax is a form of severance tax, imposed on account of the removal of the crude oil without regard to whether or how much income is subsequently realized. If not, the tax is something other than a severance tax—perhaps an income tax for which liability is incurred only to the extent that the producer ultimately realizes income from the removed crude oil.

In the case of the WPT, the parties stipulated that, while several appellants lost barrels of crude oil after removal from the premises, none received a refund or credit for the WPT paid with respect to those barrels. J.A. 19. As the New Jersey Supreme Court correctly determined, "[t]he fact that the posted price may fall subsequent to the lifting of the oil or that some barrels may be lost following severance from the lease is irrelevant" to the producer's tax liability. J.S. App. 28a-29a.

It follows that the WPT "is a site-specific cost of business comparable to an ordinary severance tax." U.S. Br. 28. Because the WPT "is incurred only for out-of-State activities" (*id.*), and because New Jersey does not disallow a deduction for any comparable in-state cost, "there is present in these cases a substantial, constitutionally problematic geographic skewing . . . of the New Jersey corporate income tax base." U.S. Br. 23.

B. The Add-Back Provision Operates as a Tax on the Removal of Crude Oil from Out-of-State Premises, in Violation of the Nexus and Fair Relationship Standards

The "nexus" and "fair relationship" prongs of the *Complete Auto* test together require a territorial link between a taxing state and both the operating incidence and the measure of the tax. The nexus standard is a "threshold requirement." *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 626 (1981). It forbids a state from levying "*any* tax" (*id.*; emphasis in original) on business activities with which it lacks a "minimal connection." *Exxon*, 447 U.S. at 219; *Mobil*, 445 U.S. at 436. The fair relationship standard "imposes the additional limitation that the *measure* of the tax must be reasonably related to the extent of the [state's] contact" with the taxpayer. *Commonwealth Edison*, 453 U.S. at 626 (emphasis in original).

It might seem at first blush that the nexus and fair relationship criteria are not implicated by New Jersey's tax scheme. After all, this Court's decisions make clear

that a state's connection with any part of a unitary business gives it sufficient nexus with the entire enterprise to impose a fairly apportioned tax on its net income from all sources. *Exxon*, 447 U.S. at 223-25; *Mobil*, 445 U.S. at 436-38. And the measure of a properly apportioned true net income tax seems plainly related to the privileges and protections provided by the state to a taxpayer that does substantial business there. *See Exxon*, 447 U.S. at 228.

But it is equally clear from the Court's decisions that the validity of a state tax depends, not on "the descriptive pigeon-hole into which a state court puts a tax," *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 443 (1940), but on its "practical effect" in light of "economic realities." *Complete Auto*, 430 U.S. at 279. An exaction that "produces a forbidden effect" (*id.* at 288) is no less invalid if it is imposed as part of an otherwise permissible income tax scheme. The Court "decline[s] to attach any constitutional significance to . . . formal distinctions that lack economic substance." *Westinghouse*, 466 U.S. at 405.

Although the New Jersey add-back provision is nominally part of the state's apportioned net income tax, its practical operation is indistinguishable in economic substance from a separately imposed New Jersey version of the federal windfall profit tax. The add-back provision requires a producer to increase its preapportionment CBT tax base by an amount equal to its federal WPT liability, to "apportion" a share of that amount to New Jersey, and to pay tax on that share at the CBT rate of nine percent. The resulting increased tax liability is exactly the same as it would be if New Jersey simply imposed an "apportioned" WPT of its own at a rate equal to nine percent of the federal rate.[16]

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[16] Assume, for example, that a taxpayer's federal WPT liability for a particular year is $1 million and that its New Jersey allocation factor is 20 percent. Under the CBT as construed, the taxpayer must add $1 million to its preapportionment tax base, of

When the add-back provision is viewed in light of its true economic effect, unprotected by the formalistic trappings of a net income tax, it becomes apparent that the provision fails the nexus and fair relationship tests.

1. The nexus requirements for a transaction tax like the WPT are quite different from those for a net income tax. When a state taxes a corporation's transactions, as opposed to its net income, the state must have a nexus with the transactions themselves, not just with the corporation. The rule is that "a state which controls the property and activities within its boundaries of a foreign corporation admitted to do business there may tax them. But the due process clause denies to the state power to tax or regulate the corporation's property and activities elsewhere." *Connecticut General Life Insurance Co. v. Johnson*, 303 U.S. 77, 80-81 (1938).

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which 20 percent (or $200,000) would be apportioned to New Jersey. The state would then apply its nine percent CBT rate to produce an increased tax liability of $18,000. Alternatively, if the state had simply adopted its own "apportioned" WPT at nine percent of the federal rate, the taxpayer's preapportionment New Jersey WPT liability would be equal to nine percent of the $1 million federal liability (or $90,000). New Jersey's apportioned share would be 20 percent or that amount (or $18,000). The effect is identical.

It is true, as the Solicitor General has noted (U.S. Br. 17 n.17), that the tax effect of the two provisions would be different for a taxpayer that has net operating losses prior to adding back WPT payments. In every other situation, however, the add-back provision operates, dollar-for-dollar, precisely the same as a New Jersey windfall profit tax. That New Jersey, in effect, allows an offset against its version of the windfall profit tax for net operating losses reported under the CBT does not change the fundamental character of the exaction. The circumstances here parallel those in *Westinghouse*, where New York's discriminatory tax credit was also adopted as part of a net income tax and therefore would likewise have had no effect on taxpayers in a net loss position. The Court nonetheless concluded, for purposes of constitutional analysis, that the "economic effect" of disallowing an income tax credit was "identical" to imposing a higher tax on the affected transactions. 466 U.S. at 404. That is the proper analysis here as well.

Consistent with that principle, the Court held recently that, when "the activity of wholesaling . . . [is] conducted wholly within [a particular state]," that state and "no other State has jurisdiction to tax" the gross proceeds derived from the activity. *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*, 107 S. Ct. 2810, 2822 (1987). Similarly, because mineral production occurs at a specific location, one state and only one state can have a nexus sufficient to tax it directly. *Commonwealth Edison*, 453 U.S. at 617. "'[T]he severance can occur in no other state' and 'no other state can tax the severance.'" *Id.*

That rule bars New Jersey from imposing a state WPT on the "removal" of a barrel of crude oil from out-of-state premises. "Removal" of a barrel of oil consists of transporting it away from the immediate vicinity of the well. Treas Reg. § 51.4996-1(d)(1). That event is indistinguishable for constitutional purposes from the "severance" of coal or other minerals. Indeed, at the time of its enactment, Congress repeatedly characterized the WPT as an "excise, or severance, tax." H.R. Conf. Rep. No. 817, *supra*, at 92; *accord* S. Rep. No. 394, *supra*, at 2, 29 154; H.R. Rep. No. 304, *supra*, at 2; *General Explanation* at 3, 26. Removal, like severance, can take place at only one location. As with severance, only the state within which the removal occurs has sufficient nexus with the activity to tax it.

2. The fair relationship requirement reinforces the nexus standard. It precludes New Jersey from imposing a tax whose measure is a percentage of the value of the crude oil produced in another state. Such a tax would not be "in 'proper proportion' to [the taxpayer's] activities within the [taxing] State" but instead would be tied improperly to its activities outside the state. *Commonwealth Edison*, 453 U.S. at 626. In such a case, "when the measure of a tax bears no relationship to the taxpayers' presence or activities in a State, a court may prop-

erly conclude under the fourth prong of the *Complete Auto Transit* test that the State is imposing an undue burden on interstate commerce." *Id.* at 629. That was the basis of the holding in *American Trucking Ass'ns v. Scheiner*, 107 S. Ct. 2829 (1987), where the Court invalidated Pennsylvania's flat tax on truckers, in part because "the amount of . . . taxes owed by a trucker does not vary directly with miles traveled or with some other proxy for value obtained from the State." *Id.* at 2844.

As the New Jersey Supreme Court acknowledged, the measure of the WPT is the post-decontrol incremental value of each barrel of crude oil "at the point the oil was removed from the producing property." J.S. App. 6a. The increased value of crude oil at the point of its removal from the producing property bears a direct relationship to the producer's activities within the producing state. But it "bears no relationship to the [producer's] presence or activities" in New Jersey, *Commonwealth Edison*, 453 U.S. at 629, nor does it "vary directly with . . . [any] other proxy for value obtained from the State." *American Trvcking Ass'ns*, 107 S. Ct. at 2844.

It is of no consequence that New Jersey's tax is "apportioned" by a three-factor formula. New Jersey is not free to impose any tax—whether apportioned or not—whose operating incidence falls on property or transactions with which the state has no nexus, or whose measure is unrelated to the taxpayer's activities in the state. Where, as here, a state lacks jurisdiction to tax an activity, it cannot acquire such jurisdiction by applying an apportionment formula, the effect of which is simply to tax the activity at a reduced rate. As in *Westinghouse*, talk of apportionment in these circumstances "serves only to obscure the issue." 466 U.S. at 398.

II. THE NEW JERSEY TAX, AS CONSTRUED AND APPLIED, UNLAWFULLY DISCRIMINATES AGAINST AN EXCLUSIVELY OUT-OF-STATE BUSINESS ACTIVITY

The Commerce Clause and the Equal Protection Clause prescribe distinct but complementary restraints on the exercise of state taxing power—"one protects interstate commerce, and the other protects persons from unconstitutional discrimination by the States." *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. at 869, 881 (1985) (footnote omitted). Each effectively prohibits the imposition of unjustifiably discriminatory tax burdens on out-of-state business. *Id.*; *Maryland v. Louisiana*, 451 U.S. 725, 754 (1981); *Western & Southern Life Insurance Co. v. State Board of Equalization*, 451 U.S. 648, 668 (1981). New Jersey's add-back provision violates both clauses because it imposes on crude oil production activities—all of which are carried out in states other than New Jersey—a discriminatorily higher effective tax burden than that imposed on in-state business activities.

A. Though Facially Neutral, the Add-Back Provision Actually Burdens Only Out-of-State Business Operations

We begin our discrimination analysis with the fundamental principles established by this Court's decisions.

First, "no State may discriminatorily tax the products manufactured or the business operations performed in any other State." *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 337 (1977). The production of crude oil is a business operation performed only outside New Jersey.

Second, that prohibition applies not only to "transactional taxes," such as the securities transfer tax in *Boston Stock Exchange*, but also to "taxes on general income." *Westinghouse*, 466 U.S. at 404. The New Jersey

CBT, like the New York franchise tax in *Westinghouse*, imposes "a tax on the income of a business from its aggregated business transactions." *Id.* "It cannot be that a State can circumvent the prohibition of the Commerce Clause against placing burdensome taxes on out-of-state transactions by burdening those transactions with a tax that is levied in the aggregate—as is the franchise tax—rather than on individual transactions." *Id.*

Third, it does not matter whether the state imposes the additional burden by applying a higher tax rate on out-of-state activities directly, by providing a tax credit for in-state activities as New York did in *Westinghouse*, 466 U.S. at 404-05, or by disallowing a deduction for costs incurred only for out-of-state activities as New Jersey has done here. In each case, "[t]he discriminatory economic effect . . . [is] identical." *Id.* at 404. As the Court held in *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 70 (1963), a state discriminates unlawfully if, while nominally applying the same tax rate to two classes of taxpayer, it "increase[s]" the "tax base" for one solely on account of an out-of-state element of its business.

Fourth, it is likewise inconsequential whether the statute is facially discriminatory or facially neutral. "[T]he Commerce Clause has a deeper meaning that may be implicated even though state provisions . . . do not allocate tax burdens between insiders and outsiders in a manner that is facially discriminatory." *American Trucking Ass'ns*, 107 S. Ct. at 2839. For example, Pennsylvania impermissibly discriminated against interstate commerce when it imposed a flat tax on trucks for a privilege that, while "nominally equivalent," was actually far more valuable to in-state than to out-of-state trucks. *Id.* at 2847. Similarly, as Professor Lockhart stated in his classic treatment of the issue, "[n]aming the favored [products] generically rather than geographically cannot justify taxation which, in fact, discriminates against interstate commerce by favoring domestic [products] over those from other states." Lockhart, *State Tax Barriers to Interstate Trade*, 53 Harv. L. Rev. 1253, 1283 (1940). A tax written in neutral terms but "tailored" to fall more heavily on out-of-state business is exactly the kind that requires "careful scrutiny" to determine whether it has a "forbidden effect." *Complete Auto*, 430 U.S. at 288-89 n.15.

New Jersey itself conceded below that the "additional tax cost" borne by integrated oil companies under the CBT "arises because [those companies] produce crude oil." App. Div. Br. at 121. The New Jersey Supreme Court similarly acknowledged that "[p]laintiffs are denied a deduction because they produce crude oil and pay the W.P.T." J.S. App. 34a. But crude oil production takes place only outside New Jersey's borders. Just as a flat tax on trucks cannot be justified on the ground that the state has extended the same "nominal privilege" (*American Trucking Ass'ns*, 107 S. Ct. at 2846) to both in-state and out-of-state trucks, the denial of a WPT deduction cannot be justified on the ground that it imposes the same nominal burden on crude oil production regardless of where it occurs. If the activity can occur only outside the taxing state, the "formalism" of facial neutrality "'merely obscures the question whether the tax produces a forbidden effect.'" *Id., quoting Complete Auto*, 430 U.S. at 288.

B. The Discriminatory Treatment of Out-of-State Business Activity Impermissibly Interferes with Interstate Commerce

1. The New Jersey Supreme Court mistakenly concluded that the add-back provision is constitutionally inoffensive "because it does not favor in-state over out-of-state economic activity." J.S. App. 34a. It is true, of course, that the tax does not favor New Jersey crude oil production—there is none. In that respect, this case pre-

sents a slight twist on the questions considered in *Boston Stock Exchange* and *Westinghouse*. Those cases established that a state could not impose a heavier tax burden on out-of-state transactions than on the same transactions conducted within the state. The question here is whether a state may single out for special tax burdens a form of business activity that is conducted only in other jurisdictions.

Though the Court has never directly addressed that question, the "clear import of [its] Commerce Clause cases is that such discrimination is constitutionally impermissible." *Boston Stock Exchange*, 429 U.S. at 335. If companies that cross state lines find that they are subjected to disproportionate tax levies solely on account of their business activities elsewhere, they will have a natural economic incentive to operate in as few states as possible to minimize their total tax burden and to avoid subsidizing their competitors. The "inevitable effect is to threaten the free movement of commerce by placing a financial barrier around" each taxing jurisdiction. *American Trucking Ass'ns*, 107 S. Ct. at 2840. When "enterprise which straddles a state line is paying more than some or all of the enterprise that is of interest only to the taxing state," Powell, *State Income Taxes and the Commerce Clause*, 31 Yale L.J. 799, 801 (1922), state boundaries lose their character as "a neutral factor in economic decisionmaking" (*American Trucking Ass'ns*, 107 S. Ct. at 2840) and become obstacles to "the free trade which the [Commerce] Clause protects." *Boston Stock Exchange*, 429 U.S. at 329.

Further, if states with no mineral production could impose special tax burdens on mineral producers solely because of their out-of-state production activities, producing states would be equally free to impose retaliatory taxes designed to burden activities conducted only in nonproducing states. As the Solicitor General stated, "the ruling of the New Jersey Supreme Court increases the

likelihood that States will deny deductions for other exclusively out-of-State site-specific costs." U.S. Br. 16. n.16. The result—a web of discriminatory state tax levies—would promote precisely the sort of "economic Balkanization" that the Commerce Clause was designed to prevent. *Hughes v. Oklahoma*, 441 U.S. 322, 325 (1979).

2. Although there is no local oil production for New Jersey to favor, the CBT's discrimination does provide "a direct commercial advantage to local business." *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959). The integrated companies that produce oil outside New Jersey and market their products within New Jersey are denied a deduction for a substantial cost of their out-of-state production activities. By contrast, non-producer independent marketers, with whom the integrated companies compete at the retail level in New Jersey, are permitted a full deduction for their cost of goods sold. As a consequence, an integrated company bears a higher effective tax cost than does a directly competing independent marketer.

The discriminatory effect can be shown by a simple illustration. Suppose that the cost of producing a barrel of domestic crude oil before WPT is 20, that the WPT cost is 10, that refining costs are 12, that the wholesale price of gasoline is 42, that marketing costs are 2, and that the price of gasoline at the pump is 46. To permit a comparison at the retail level, assume further that the integrated company earns no profit at the production or refining levels but earns the same profit as the independent marketer at the retail level. The following table shows that New Jersey's add-back provision operates to tax an integrated company more heavily than the independent marketer with which it competes:

Producer/Marketer		*Non-Producer/Marketer*	
46	gross receipts	46	gross receipts
−42	cost of goods sold [17]	−42	cost of goods sold [17]
4	federal gross income	4	federal gross income
− 2	marketing expense deduction	− 2	marketing expense deduction
2	federal taxable income	2	federal taxable income
+10	N.J. WPT add-back	+ 0	N.J. WPT add-back (inapplicable)
12	N.J. tax base	2	N.J. tax base

Altering the assumptions to account for a profit at the production and refining stages does not negate the discriminatory effect of the add-back provision. The integrated company would still be subjected to a higher effective tax burden, per barrel of product sold in New Jersey, than its non-producer independent competitor. Its taxable income, unlike the independent's, is inflated because of the state's refusal to recognize a substantial component of the company's cost of production.

New Jersey acknowledges that non-producing independent marketers, unlike their integrated competitors, are permitted under the CBT "to deduct the WPT (as part of their cost of goods sold)." Br. in Resp. to U.S. 2. In its view, however, the discrimination presents no constitutional problem because the independents' entitle-

[17] A company's "cost of goods sold"—including the acquisition cost of finished products and costs "incidental to and necessary for production or manufacturing operations or processes" (Treas. Reg. § 1.471-11(b)(1))—is subtracted from gross receipts to determine federal gross income. Treas. Reg. § 1.61-3(a). The integrated company's cost of goods sold in the illustration includes pre-WPT production costs of 20, WPT costs of 10, and refining costs of 12, for a total of 42. The independent marketer's cost of goods sold consists of the wholesale gasoline acquisition cost of 42. (The illustration would not change if the integrated company took its WPT costs as a deduction from gross income instead of as part of its cost of goods sold. The net result would be identical.)

ment to the deduction "does not relate to the fact that they operate in-state." *Id.* In other words, according to New Jersey, the fact that some members of the favored class of independent marketers may operate in interstate commerce insulates from Commerce Clause attack the discrimination against out-of-state crude oil production.

But the Commerce Clause prohibits the imposition of a discriminatory tax burden on out-of-state "business operations," *Boston Stock Exchange*, 429 U.S. at 337, even if the burden falls only on a segment of interstate operators. In *American Trucking Ass'ns*, for example, the Court struck down Pennsylvania's discriminatory axle tax even though "*some* out-of-state carriers . . . pay the axle tax at a *lower* per-mile rate than some Pennsylvania based carriers." 107 S. Ct. at 2842 (emphasis added). Conversely, in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 271 (1984), the Court held that a Hawaii liquor tax exemption was "clearly discriminatory, in that it applies only to locally produced beverages, even though it does not apply to all such products." In each case, the discrimination offended the Commerce Clause even though the line that divided the two classes did not coincide precisely with the in-state/out-of-state distinction.

Under this Court's decisions, "a tax violates the Commerce Clause 'when it unfairly burdens commerce by exacting more than a just share from the interstate activity.'" *Tyler Pipe*, 107 S. Ct. at 2820, *quoting Washington Department of Revenue v. Association of Washington Stevedoring Cos.*, 435 U.S. 734, 738 (1978). Where, as here, a state tax discriminates against a category of interstate operators solely on the basis of an extrastate feature of their businesses, it exacts more than a "just share" from a business that is necessarily interstate.

Exxon Corp. v. Governor of Maryland, 437 U.S. 117 (1978), on which the New Jersey Supreme Court relied

(J.S. App. 34a), is of no help to the state. The Court there upheld against Commerce Clause challenge a Maryland statute prohibiting crude oil producers and refiners from operating retail service stations within the state. That enactment, "an outgrowth of the 1973 shortage of petroleum," was designed to protect the "competitiveness of the [local] retail market" against perceived inequities in the distribution and pricing of gasoline. 437 U.S. at 121, 124. As the Solicitor General correctly noted, the Maryland case "involved a regulatory measure, not a tax measure, and New Jersey has advanced no regulatory objectives in these cases." U.S. Br. 22 n.22.

Furthermore, the power to exclude a company from doing business within a state does not imply the power, asserted by New Jersey here, to admit the company on the condition that it submit to a discriminatory tax burden that would otherwise offend either the Commerce Clause, *Western Union Telegraph Co. v. Kansas*, 216 U.S. 1, 47-48 (1910), *Pullman Co. v. Kansas*, 216 U.S. 56 (1910), or the Equal Protection Clause. *Metropolitan Life Insurance*, 470 U.S. at 875; *Western & Southern Life Insurance*, 451 U.S. at 667-68.

Finally, New Jersey cannot justify its discriminatory application of the add-back provision on the ground that "nonproducing marketers did not benefit, as did plaintiffs, from the decontrol of crude oil prices, but had to purchase their crude oil at the higher decontrolled prices." J.S. App. 34a. To the extent that an integrated company has benefited from decontrol, the benefit is reflected in its overall net income, a fair portion of which is properly subject to taxation by New Jersey under the CBT *without* the add-back provision.

WPT payments represent not the producer's but the federal treasury's share of higher crude oil prices. From the producer's standpoint, WPT liability is a burden, not a benefit. New Jersey's discriminatory attempt to tax both the increased net income *and* the WPT cost resulting from decontrol is not a rational way to equalize the tax treatment of producers and non-producers. On the contrary, it unjustifiably puts producers at a material economic disadvantage.

CONCLUSION

The judgment of the Supreme Court of New Jersey should be reversed.

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APPENDICES

APPENDIX A

AMOUNTS AT ISSUE FOR 1980 AND 1981

	1980				1981			
Company	N.J. CBT Liability Before Add-Back of WPT Payments	N.J. CBT Liability After Add-Back of WPT Payments	Additional Tax Liability Attributable to WPT Add-Back	Percentage Increase in Tax Burden	N.J. CBT Liability Before Add-Back of WPT Payments	N.J. CBT Liability After Add-Back of WPT Payments	Additional Tax Liability Attributable to WPT Add-Back	Percentage Increase in Tax Burden
Amerada Hess	$10,852,307	$12,504,242	$ 1,651,935	15%	$ 864,208	$ 7,561,840	$ 6,697,632	775%
Atlantic Richfield	$ 1,275,921	$ 1,633,808	$ 357,887	28%	$ 477,001	$ 1,309,033	$ 832,032	174%
Chevron	$ 5,825,582	$ 6,947,422	$ 1,121,840	19%				
Cities Service	$ 1,344,049	$ 1,618,395	$ 274,346	20%	—0—	$ 912,204	$ 912,204	∞
Conoco	$ 385,665	$ 523,399	$ 137,734	36%				
Exxon	$15,314,745	$19,038,950	$ 3,724,205	24%				
Gulf	$ 638,411	$ 997,987	$ 359,576	56%	$ 112,834	$ 1,356,153	$ 1,243,319	1102%
Mobil	$ 1,711,268	$ 2,235,947	$ 524,679	31%				
Phillips	$ 170,593	$ 195,684	$ 25,091	15%				
Shell	$ 2,749,654	$ 3,509,330	$ 759,676	28%	$3,039,560	$ 5,031,746	$ 1,992,186	66%
Tenneco	$ 496,647	$ 592,949	$ 96,302	19%				
Texaco	$ 4,077,155	$ 5,064,761	$ 987,606	24%				
Union	$ 315,124	$ 384,965	$ 69,841	22%				
Total	$45,157,121	$55,247,839	$10,090,718	22%	$4,493,603	$16,170,976	$11,677,373	260%

Source: The figures in this table were derived from the complaints, assessment notices, and final determination letters contained in the record.

APPENDIX B

ACTUAL AND EFFECTIVE NEW JERSEY ALLOCATION FACTORS

Company	1980 Actual Allocation Factor [1]	1980 Effective Allocation Factor [2]	1980 Percentage Increase in Allocation Factor	1981 Actual Allocation Factor [1]	1981 Effective Allocation Factor [2]	1981 Percentage Increase in Allocation Factor
Amerada Hess	22.6582%	26.1072%	15%	23.3437%	204.2579%	775%
Atlantic Richfield	0.9030%	1.1563%	28%	1.0995%	3.0174%	174%
Chevron	4.2930%	5.1135%	19%			
Cities Service	3.1826%	3.8322%	20%	3.2046%	∞ [3]	∞ [3]
Conoco	1.2209%	1.6569%	36%			
Exxon	6.9553%	8.6467%	24%			
Gulf	1.2877%	2.0130%	56%	1.3564%	16.3027%	1102%
Mobil	6.4603%	8.4410%	31%			
Phillips	0.2279%	0.2614%	15%			
Shell	1.9703%	2.5147%	28%	1.8343%	3.0365%	66%
Tenneco	1.2223%	1.4593%	19%			
Texaco	3.6664%	4.5546%	24%			
Union	0.4179%	0.5105%	22%			

[Footnotes on next page.]

[1] "Actual allocation factor" refers to the New Jersey allocation factor as reported and accepted or as adjusted by the Director of the Division of Taxation. The figures are derived from the complaints, assessment notices, and final determination letters contained in the record.

[2] "Effective allocation factor" refers to the New Jersey allocation factor that would be required to yield the CBT liability actually assessed by New Jersey assuming no add-back of WPT payments. It is derived by dividing each company's assessed CBT liability by 9 percent (the CBT rate). The quotient equals the amount of the company's post-apportionment "entire net income" as determined by the Director of the Division of Taxation. That figure is then divided by the company's "entire net income" from all sources, before add-back of WPT payments, to determine the "effective allocation factor."

[3] Because Cities Service's 1981 "entire net income" before WPT add-back was a negative figure, an adjustment to its allocation factor could not, as a mathematical matter, affect its pre-add-back CBT tax liability of zero. Only by increasing the company's "entire net income" could New Jersey assess any CBT tax liability for that year.

APPENDIX C *

SUMMARY OF STATE TAX SCHEMES DENYING DEDUCTION FOR WINDFALL PROFIT TAX PAYMENTS

Georgia

The Georgia state code provides that "[e]very domestic corporation and every foreign corporation shall pay annually an income tax" on "its Georgia taxable net income." Ga. Code Ann. § 48-7-21(a) (Supp. 1987). If a corporation conducts business both within and without the state, Georgia taxes that "portion of [its] net income . . . attributable to property owned or business done within [the] state," as determined in accordance with a three-factor (property, payroll, and gross receipts) formula. § 48-7-31(d)(2).

Georgia bases its definition of "taxable net income" on the federal scheme. Under the state code, a "corporation's taxable income from property owned or from business done in [the] state shall consist of the corporation's taxable income as defined in the Internal Revenue Code of 1986, with [specified]adjustments." § 48-7-21(a). One such adjustment requires an add-back of various taxes, including "any taxes on, or measured by, net income or net profits paid or accrued within the taxable year imposed by the authority of the United States . . . to the extent such taxes are deducted in determining federal taxable income." § 48-7-21(b)(2).

Georgia tax administrators have determined that the WPT is a tax "on, or measured by, net income or net profits" and that WPT payments must therefore be added back to the federal tax base to determine "taxable net income."

* This appendix is a slightly updated version of the material included as Appendix G (pp. 85a-91a) to the Jurisdictional Statement in No. 87-453.

Iowa

Iowa taxes the "net income" of "each [domestic] corporation" and "every foreign corporation doing business in [the] state." Iowa Code Ann. § 422.33 (West 1971 & Supp. 1988). The state uses a single-factor (gross sales) formula to apportion to Iowa a share of the net income of a corporation doing business both within and without the state. § 422.33.2(b)(4). Under the state code, the "term 'net income' means the taxable income before the net operating loss deduction, as properly computed for federal income tax purposes under the Internal Revenue Code," with specified "adjustments." § 422.35.

In 1982, the state expanded its list of "adjustments," making the amendment effective retroactively to tax years beginning on or after January 1, 1981. The amendment provided that "the amount of windfall profits tax deducted under section 164(a) of the Internal Revenue Code" must be added back to federal taxable income for purposes of computing net income subject to the Iowa corporate tax. § 422.35.9.

In *Shell Oil Co. v. Bair*, 417 N.W.2d 425 (Iowa 1987), the Supreme Court of Iowa ruled that the state's add-back provision applies only "where payment . . . of the federal windfall profits tax has been taken by an oil producer as a deduction [from gross income] in arriving at net income on its federal return," and does not apply where the producer "in fact claimed the amount of the windfall profits tax as an inventory cost for federal tax purposes." *Id.* at 428, 429. The Court further held that the statute, as thus construed, does not violate the Due Process Clause, the Commerce Clause, or the Equal Protection Clause of the United States Constitution. *Id.* at 430-32.

Minnesota

Minnesota imposes an annual franchise tax measured by a corporation's "taxable income." Minn. Stat. Ann.

§ 290.02 (West Supp. 1988). In computing its Minnesota "taxable income," a corporation starts with its "federal taxable income," as defined by the Internal Revenue Code, to which it adds and from which it subtracts specified items. § 290.01(19), (19c), (19d), (22), (29). Among the items to be added to federal taxable income is "the amount of any windfall profits tax deducted under section 164 or 471 of the Internal Revenue Code." § 290.01(19c)(4).

The resulting amount, in the case of a unitary business that operates partly within and partly without the state, is then apportioned to Minnesota under a weighted three-factor formula representing the in-state ratios of sales (70 percent), property (15 percent), and payroll (15 percent). §§ 290.17(4), 290.191(2).

New York

New York imposes a franchise tax measured by a corporation's "entire net income." N.Y. Tax Law § 209.1 (McKinney 1986 & Supp. 1988). For corporations doing business both within and without New York, the state's share of multistate income is determined by multiplying the corporation's "entire net income" by a three-factor (property, payroll, and gross receipts) formula. § 210.3(a).

"The term 'entire net income' means total net income from all sources, which shall be presumably the same as the entire taxable income . . . which the taxpayer is required to report to the United States treasury department . . . ." § 208.9. For state franchise tax purposes, however, "[e]ntire net income shall be determined without the exclusion, deduction or credit of . . . taxes on or measured by profits or income paid or accrued to the United States." § 208.9(b)(3). The New York State Tax Commission, in an "Opinion of Counsel," has ruled that the WPT is a tax on or measured by profits and that, as a consequence, WPT payments must be added back to

federal taxable income for purposes of computing the state tax base. TSB-M-82 (22) C, Corporation Tax (July 12, 1982), *reprinted in* 1 N.Y. St. & Loc. Tax Serv. (P.H.) ¶ 13,229; 1 N.Y. St. Tax Rep. (CCH) ¶ 9-909.

North Dakota

North Dakota imposes a tax on the "taxable income" of corporations doing business there, as apportioned to North Dakota by a four-factor (property, payroll, gross sales, cost of goods sold) formula. N.D. Cent. Code Ann. § 57-38 (Allen Smith 1983 & Supp. 1987). "'Taxable income' . . . shall mean the taxable income . . . for federal income tax purposes under the United States Internal Revenue Code of 1954, as amended, plus or minus such adjustments as may be provided by this act and chapter or other provisions of law." § 57-38-01.8. In computing North Dakota taxable income, a corporation must increase federal taxable income "by the amount of any income taxes . . . to the extent that such taxes were deducted to determine federal taxable income." § 57-38-01.3.1(d).

For the initial year of the WPT's effectiveness, the state enacted a special statute governing the state tax treatment of WPT payments. It provided: "As to individuals, estates, trusts, and corporations, the crude oil windfall profit tax . . . shall be allowable as a deduction in computing taxable income for the first taxable year only, beginning on or after January 1, 1980; provided that the deduction for a corporation shall not exceed one million dollars." Former § 57-38-01.21(a), N. Dak. St. Tax Rep. [CCH] ¶ 11-018. For subsequent tax years, the state apparently has allowed taxpayers to treat WPT payments as fully deductible from the state's tax base. Moreover, because North Dakota has not treated the WPT as an "income" tax, WPT payments have not been subject to the state's add-back provision, which applies to "income taxes" or "franchise or privilege taxes measured by income." § 57-38-01.3.1(d). As a practical matter, therefore, the only limit that North Dakota has placed on the deductibility of WPT payments is the $1 million cap applicable to corporations in 1980.

South Carolina

With respect to a multistate enterprise conducting business within South Carolina, the state imposes a tax on the portion of the enterprise's "entire net income" that "reasonably represents the proportion of the trade or business carried on within [the] State." S.C. Code Ann. §§ 12-7-230, 12-7-250 (Law. Co-op. 1977 & Supp. 1987). The state uses a three-factor (property, payroll, and gross receipts) formula to derive an apportioned share of the business's "entire net income." *See* S.C. State Tax Commission Regulation 117-87.17.

In computing its "entire net income," a corporation starts with its "gross income and taxable income as determined under the Internal Revenue Code with [specified] modification[s]." § 12-7-415. The state code provides that the "deductions used in computing adjusted gross income and taxable income" for federal tax purposes must be "modified" in several respects. § 12-7-430(d). One such modification specifies that "there is no deduction for . . . any income taxes, or any taxes measured by or with respect to net income." § 12-7-430(d)(1).

In 1982, the South Carolina Attorney General, construing a similar predecessor provision, issued an opinion on the deductibility of WPT payments. Relying on South Carolina case law that all "ambiguity" must be resolved against the taxpayer, the Attorney General concluded that the "windfall profit tax is . . . a tax with respect to income" because it "focuses on specific profits" and that WPT payments therefore "may not be deducted in computing net income." 82 Op. Att'y. Gen. No. 13 (Mar. 10, 1982). Based on that opinion, the state does not allow a deduction for WPT payments.

Wisconsin

Wisconsin imposes a franchise tax on the "entire net income" of each corporation doing business within its borders. Wis. Stat. Ann. § 71.01(12) (West 1969 & Supp. 1987). If the corporation is a multistate unitary business, Wisconsin taxes an apportioned share of the enterprise's net income determined pursuant to a three-factor (property, payroll, and sales) formula. § 71.07(2).

Under the Wisconsin code, "'[n]et income' means, for corporations, 'gross income' less allowable deductions." § 71.02(1)(c). When the WPT was enacted, the state code provided that, in determining "net income," "[i]ncome, excess profits, war profits and capital stock taxes imposed by the federal government are not deductible from gross income." § 71.04(3). The state legislature, however, apparently did not believe that the WPT, as a "temporary excise tax" on crude oil production, was subject to that provision. Wisconsin Legislative Fiscal Bureau, Analysis of Amendment to Wis. Stat. § 71-04 (Apr. 23, 1981). The state therefore amended section 71.04(3) to provide specifically that "the windfall profit tax under section 4986 of the internal revenue code is not deductible from gross income." 1981 Wis. Laws ch. 20, § 1090c (July 31, 1981).

In *Mobil Oil Corp. v. Ley*, 142 Wis. 2d 108, 416 N.W.2d 680 (Ct. App. 1987), the Court of Appeals of Wisconsin rejected the taxpayer's state constitutional challenge to the non-deductibility of WPT payments. The Supreme Court of Wisconsin subsequently denied a petition to review the Court of Appeals' decision. *Mobil Oil Corp. v. Ley*, No. 86-1221 (May 3, 1988).

APPENDIX D

CHANGES TO RULE 28.1 STATEMENTS *

AMERADA HESS CORPORATION

Add

LubExpress Development Company, Inc.
LubExpress Land Company, Inc.
LubExpress Operating Company, Inc.

Delete

Esperanza Petroleum Corporation
Oasis Oil Company of Libya, Inc.

ATLANTIC RICHFIELD COMPANY

Add

ARCO Centennial Corp.
ARCO Chemical Asia Pacific, Ltd.
ARCO Chemical Canada Inc.
ARCO Chemical China, Limited
ARCO Chemical Company
ARCO Delaware Company
ARCO Chemical (Deutschland) GmbH
ARCO Chemical Espana Co.
ARCO Chemical Europe, Inc.
ARCO Chemical (Europe) Inc.
ARCO Chemical Export Sales Company
ARCO Chemical Foreign Sales Corporation
ARCO Chemical Indonesia, Inc.
ARCO Chemical Japan, Inc.

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* The complete lists of affiliated companies are set forth in Appendix I (pp. 105a-155a) to the Jurisdictional Statement in No. 87-453 and in Appendix G (pp. 70a-72a) to the Jurisdictional Statement in No. 87-464. This Appendix lists only amendments to the prior lists to make them currently accurate.

ARCO Chemical Korea, Inc.
ARCO Chemical Middle East, Inc.
ARCO Chemical New Zealand, Inc.
ARCO Chemical Overseas Services, Inc.
ARCO Chemical Pan America, Inc.
ARCO Chemical Products Europe, Inc.
ARCO Chemical (Singapore) PTE, Ltd.
ARCO Chemical Taiwan, Inc.
ARCO Chemical Technology, Inc.
ARCO Chemical Texas, Inc.
ARCO Chemical (Thailand), Limited
ARCO Chemical Trading, Inc.
ARCO Chemie Nederland, Ltd.
ARCO Chimie France Corporation
ARCO Chimie France S N C
ARCO Elastomers, Inc.
ARCO France, Inc.
ARCO Idemitsu Corporation
ARCO/JSP Company
ARCO Plastics, Inc.
ARCO Synthesis, Inc.
Chiunglong Petrochemical Co., Ltd.
EnArco Elastomers Company
EnArco Resins SpA
N.T. Development, Inc.
Nihon Oxirane Co., Ltd.
Oxirane Chemical Company
Oxirane Technology (Japan) Company
P.T. Gema Polytana Kimia
Yukong ARCO Chemical Ltd.

Delete

ABE Beverage, Inc.
Almeg Extrusion Company, Inc.
Ambler Mining Company
Anaconda Exploration New Zealand Limited
Anamet, S.A. de C.V.

ARCO Chemical IBERICA, S.A.
ARCO Oil Limited
Arpet Petroleum Limited
A/S Skaland Graftiverk
Atlantic Richfield Oil Limited
Atlantic Richfield de Mexico, S.A. de C.V.
Caribou Chaleur Bay Mines Ltd.
Caribou-Smith Mines Ltd.
Centroamerica de Cobre, S.A.
Cobre de Hercules, S.A.
Cobre de Mexico, S.A.
Cobroeel, S.A. de C.V.
Compania Minera Kappa, S.A.
Compania Minera Penaeebre, S.A.
Cupro San Luis, S.A. de C.V.
Delaware Bay Transportation Company
Dexter de Mexico, S.A.
Empresa de Comercio Exterior Mexicano, S.A. de C.V.
Ericsson
Flower Street Limited
Gravity Adjustment, Inc.
Imperial Eastman de Mexico, S.A.
Impulsora De Cobre, S.A. de C.V.
Industrias Nacobre, S.A. de C.V.
Industrias Technos, S.A. de C.V.
Kronos, Computacion y Teleprecese, S.A. de C.V.
Lavan Petroleum Co.
Lingebronce, S.A.
Manufacturera Mexicana De Partes para Automovites, S.A. de C.V.
Mayflower Mining Company
Minera Anaconda Limitada
Montero, Empresa Para La Industria Quimica
Nacional de Cobre, S.A.
P.T. Arutmin Indonesia
P.T. Elnusa Chemlink
Park City Ventures
Park Cummings Mining Company

Park-Premier Mining Company
Participaciones Mexicanas, S.A. de C.V.
Prince Consolidated Mining Company
Productos Especiales Metalicos, S.A.
Richfield U.K. Petroleum, Limited
Servicios Industriales Nacobre, S.A.
Sinclair (U.K.) Oil Company Limited
Sinclair Venezuelan Oil Company
Sociedade Anonima Marvin
Selvanmex, S.A. de C.V.
Swecomex, S.A.
Tubes Flexibles, S.A.
William Prym de Mexico, S.A.

CHEVRON U.S.A. INC./GULF OIL CORPORATION

Add

Chevron Development Company Limited
BGD Company
Chevron Chemical (FSC)
Plastigama S.A.
Compania Minera Chevron Dominicana, S.A.
Mineraloel-Additives Vertriebsgesellschaft m.b.H.
GOC Acquisition Corporation
Lost Hills Water Company
Ocean Facilities Inc.
Ocean Charters, Inc.
Chevron (U.K.) Offshore Investments Limited
Chevron Oil (TNS) Limited
Chevron Oil (TOGH) Limited
Chevron Oil (TOI) Limited
Chevron Oil (TNS) Limited
Chevron Chemical (Hong Kong) Limited
Chevron Germany Inc.
Chevron Niugini Pty. Limited
Chevron Tankers (Bermuda) Limited
Gulf Pension Fund Trustee Company Limited
Chevron Pension Fund Trustee Company Limited
575 Market Street Building Corporation

Delete

Amax Inc.
Bahama California Oil Company
Belize Chevron Oil Company
Chevron Singkarak Inc.
California Ecuador Petroleum Company
Chevron Canada Petroleum Limited
Standard Development Company Limited
A/S Hydrantanlaegget Koebenhavns Lufthavn, Kastrup
Arabian Chevron Trading Company
Caltex Mediterranean Limited
Eastern Transport Corporation
Chevron Oil Company (Ghana)
Chevron Oil Company of Equatorial Guinea
Chevron Oil Company of Ethiopia
Chevron Oil Company of Kenya
Chevron Oil Company of Liberia
Chevron Oil Company of Madagascar
Chevron Oil Company of Mauritius
Chevron Oil Company of Morocco
Chevron Oil Company of South Africa
Chevron Oil Company of South West Africa
Chevron Oil Company of Thailand
Chevron Petroleum Company of Greenland
Chevron Canada Petroleum Limited
Argentine Gulf Oil Company
Chevron International Chemicals Inc.
Crediton Enterprises, Inc.
Gulf Chemicals International, Inc.
Gulf Doric Western Corporation
Harshaw Chemical Company, The
Penrith Enterprises, Inc.
Ripon Enterprises, Inc.
Compania Comercial Chevron, S.A.
Gulf Oil North Sea Limited
Gulf Asian Investments Company Limited
Gulf Offshore Cameroon Company
Gulf Oil Company of Cameroon
Gulf Oil Germany Inc.

Plaschem International Co. (Hong King) Limited
Gulf West Cameroon Exploration Company
Transocean Gulf Oil Company
Caribbean Gulf Refining Corporation
Balinesian Gulf Oil Limited
Gulf Fujairah Petroleum Limited
New Frontiers Limited
Niugini Gulf Oil Pty. Limited
Gulf (U.K.) Offshore Investments Limited
Gaelic Oil Company Limited, The
Silvertown Lubricants Limited
Zaire Gulf Oil Company
Compania Petrolera Chevron Guatemala
Compania Petrolera Chevron Honduras
Dominion Oil Limited

CONOCO INC.*

Add

Biotech Research Laboratories Inc.
Du Pont Canada Inc.
Molecular Biosystems Inc.
Conoco Exploration Ltd.

EXXON CORPORATION

Add

BT Asia Securities Limited
F.T. Shyoji K.K.
Federated Pipe Lines Ltd.
Groupement Petrolier de la Cote D'Azur
Home Energy Company Ltd.
Intoplane Service Company Limited
K.K. Kyoei Agency
K.K. Marutaka Sekiyu
Minerals Limited

* The Seagram Company Ltd., through its wholly-owned subsidiary companies, owns approximately 23 percent of E. I du Pont de Nemours and Company common stock.

Mr. Lube Canada Inc.
158437 Canada Ltd.
158883 Canada Inc.
159129 Canada Inc.
160837 Canada Limited
P.A.C. S.A.R.L. (Pinson Allegret-Causse)
S.A.R.L. Viain
Sulbath Exploration Ltd.
Tonen Energy and Marine (Singapore) Pte. Ltd.
Tonen Properties Inc.
Tonex Company Limited
Worex S.N.C.

Delete

Abu Dhabi Company for Onshore Oil Operations
A/S Futurum
Building Products of Canada Limited
D.O.C. Dutch Offshore Consortium B.V.
Daitsu Sangyo K.K.
Eastcoast Spill Response Inc.
Groupement pour l'Etude d'un Pipeline Bordeaux Toulouse
Hankyu Ferry K.K.
K.K. Toko
Kobe Port Service Kabushiki Kaisha
Leco Inc.
Limburgsche Maatschappij voor Gasdistributie Limagas N.V.
Maatschappij voor Intercommunale Gasdistributie Intergas N.V.
Maatschappij voor Intercommunale Gasvoorziening in Oost-Brabant "OBRAGAS N.V."
Nichimo Kabushiki Kaisha
Norddeutsche Oelleitungs-gesellschaft m.b.H.
Pinpoint Retail Systems Inc.
Renown Building Materials Limited
Supertex, Inc.
305120 Alberta Ltd.
Wohnungsbaugesellschaft, Steimbke-Rodewald G.m.b.H.

MOBIL OIL CORPORATION

Add

Andrews Oil Pty. Limited
Arabian Chemical Terminals
Balgee Oil Pty. Limited
Carburanti Lubrificanti E Affini Meridionali (CLEAM S.p.a.)
Jet Aviation Saudi Arabia Company Limited
Kubler Heizol A.G.
La Centrafricaine des Petroles (PETROCA)
MARS S.p.A.—Milan Airport Refueling Service
Mobilpetro Sociedad Amonima
MOFELT—Sociedade Portuguesa De Feltros Betuminosos, S.A.
Norvac Pty. Limited
Primagaz
Red Sea Plastic Factory Company Limited
Societe Tahitienne Des Oleoduce
Tar Tankanlage Rumlang AG
Tonex Company Limited
Trinity Petroleum Services Pty. Limited

Delete

D. Muhlenbruch GmbH
D. Muhlenbruch GmbH & Co. KG
FACEL
Frome-Broken Hill Company Proprietary Limited
Futuro Enterprises (Christchurch) Ltd.
Futuro Homes (N.Z.) Ltd.
Goteborgs Branslesortering AB
Milan Airport Refueling Service
Oil Service Company of Iran (Private Company)
Poly Oil Chimie (P.O.C.)
Santa Clara Waste Water Company
Societe d'Armement Fluvial et Maritime "SOFLUMAR"
Societe d'Entreposage de Bobo-Dioulasso (S.E.B.)
Societe d'Entreposage d'Hydrocarbures de Bingo (SEHBI)

Society Des Huiles Lemanhieu
Society Francaise Stoner-Mudge
Society Industrielle des Asphaltes et Petroles de Lattaquie (Syrie) S.A.
Society Nouvelle pour l'Epuration des Huiles de Transformateurs—Septra
Total Centrafricaine de Gestion (TOCAGES)
Transalpine Finance Holdings S.A.
WSG, Warmeservice Gmbh
Wyco Pipe Line Company

PHILLIPS PETROLEUM COMPANY

Add

Biosciences Corporation of Texas (BIOTX)
Incinatrol Inc.
Phillips Petroleos Chiles S.A.
Wadley Biosciences Corporation

Delete

White River Shale Oil Corporation

SHELL OIL COMPANY

Shell Oil Company's parent corporation is now Shell Petroleum Inc., which, in turn, is owned directly and indirectly by Royal Dutch Petroleum Company (a Netherlands corporation) and The "Shell" Transport and Trading Company, p.l.c. (a United Kingdom corporation). In other respects, the earlier listing remains accurate.

TENNECO OIL COMPANY

Add

Tennessee Gas Pipeline Company (Delaware)
Tenneco Corporation (Delaware)
Vibromax SCI (France-in liquidation)
Butler (1843) Ltd. (United Kingdom)

Delete

Tenneco Corporation
Poclain S.A. France
SBG Puerto Rico, Inc. (Puerto Rico)
Ekco S.A.R.L. (France)
Tenneco Oil Company of Nigeria Unlimited (Nigeria)
Omni-Pac GmbH (Germany)
Omni-Pac S.A.R.L. (France)
Tunisian American Date Company (Tunisia)
Case Vibromax GmbH (Germany)
Case Vibromax GmbH & Co. (Germany)
Vibromax France SARL (France)
Vibromax SCI (France)
Case Poclain GmbH & Co. (Germany)
Depositas Del Norte, S.A. (Spain)
Terminales Quimicos S.A. (Spain)
Case Vibromax GmbH und Co. (Germany)
Marchon-Paragon Sulphonation (PTY) Ltd.
Buler (1943) Ltd. (United Kingdom)

TEXACO INC.

Delete

Deutsche Texaco AG